



Country Strategy and Program

October 2006

Indonesia 2006–2009

Asian Development Bank

INDONESIA



CURRENCY EQUIVALENTS

(as of 29 September 2006)

Currency Unit	–	rupiah (Rp)
Rp1.00	=	\$0.000110
\$1.00	=	Rp9,226

ABBREVIATIONS

ADB	–	Asian Development Bank
ADF	–	Asian Development Fund
ASEAN	–	Association of Southeast Asian Nations
AusAID	–	Australian Agency for International Development
Bappenas	–	Badan Perencanaan Pembangunan Nasional (National Development Planning Agency)
BIMP-EAGA	–	Brunei Darussalam, Indonesia, Malaysia, and Philippines-East ASEAN Growth Area
CAPE	–	country assistance program evaluation
CIDA	–	Canada International Development Agency
CSP	–	country strategy and program
DFID	–	Department for International Development of the United Kingdom
DPSP	–	Development Policy Support Program
DSF	–	Decentralization Support Facility
GDP	–	gross domestic product
GTZ	–	Gesellschaft fuer Technische Zusammenarbeit (German Agency for Technical Cooperation)
IMT-GT	–	Indonesia, Malaysia, Thailand Growth Triangle
IRM	–	Indonesia Resident Mission
JBIC	–	Japan Bank for International Cooperation
KPK	–	Komite Pemberantasan Korupsi (Commission for Eradication of Corruption)
MDG	–	Millennium Development Goal
MTS	–	medium-term strategy
NGO	–	nongovernment organization
PKPS-BBM	–	Program Kompensasi Pengurangan Subsidi Bahan Bakar Minyak (Fuel Subsidy Reduction Compensation Program)
PSOD	–	Private Sector Operations Department
RPJM	–	Rencana Pembangunan Jangka Menengah (Medium-Term Development Plan)
SMEs	–	small and medium-sized enterprises
SOE	–	state-owned enterprise
TA	–	technical assistance
UN	–	United Nations
UNDP	–	United Nations Development Programme

NOTE

In this report, "\$" refers to US dollars.

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EXECUTIVE SUMMARY

Indonesia saw rapid growth and declining poverty in the early 1990s, then sudden economic deterioration and heightened poverty in 1997–2000, following the Asian financial crisis. The crisis exposed a lack of good governance. Since the crisis, the macroeconomic focus and debt reduction have led to low development spending, while private consumption has been the main driver of growth. Progress toward the Millennium Development Goals (MDGs) has been mixed.

The Government's Medium-Term Development Plan 2005–2009 seeks to raise levels of sustainable economic growth, create jobs, and accelerate the achievement of the MDGs. The current investment climate discourages domestic and foreign investors, and the country is losing competitiveness. Poverty incidence returned to pre-crisis levels, although recently it has gone back up. A large number of households are vulnerable to falling back into poverty. Despite its coalition basis, the present Government has established a strong reform agenda for infrastructure, the investment climate, and the financial sector, and has introduced a new budget management system.

Asian Development Bank (ADB) assessments have identified several constraints on development, which the country strategy and program (CSP) aims to help the Government address. Absence of a stable and consistent legal and regulatory environment, together with proliferating local taxes and regulations, are two factors impeding investment. Infrastructure provision is lower than in many other countries in the region. Capital markets and nonbank financial institutions are relatively small. Decentralization has left many uncertainties in the relations among levels of government, and weak local capacities. Low development spending is accompanied by weak public sector management. Development spending needs to be increased to attain higher economic growth with job creation, reduce poverty, and accelerate the achievement of the MDGs.

From 1998 to 2005, ADB's lending to Indonesia fell significantly. After 2002, the quality of the project portfolio improved, and the disbursement ratio has been higher than the ADB average. Problems remain in project start-up and implementation. As recommended by a country assistance program evaluation, the CSP analysis has been constraint-focused and coverage is better aligned with Asian Development Bank (ADB) and Government resources, with a greater emphasis on country systems. In 2005, ADB's operations turned around, through policy reform support to facilitate transition and a sustained focus on portfolio management. In 2005, ADB also resumed private sector operations.

ADB's strategy for 2006–2009 is to help the Government achieve higher levels of pro-poor sustainable growth and to enhance social development, with a key thematic focus on governance and anticorruption measures in all operations. Five areas of engagement have been derived to address the main constraints: improved infrastructure and infrastructure services, deepened financial sector, improved decentralization, accelerated MDG achievement, and strengthened environment and natural resource management. A public sector lending and nonlending program has been agreed around these areas of engagement, focusing on group-I and some group-II priorities of ADB's medium-term strategy II.

The CSP uses innovative approaches. ADB will provide program lending using the single-tranche cluster approach to support the Government's medium-term reform agenda. Investment projects will employ multi-tranche financing facility operations in several sectors to ensure long-term investment and policy engagement. Areas of engagement will be supported

through technical assistance clusters, to align assistance with emerging demands and provide more flexibility. Private sector operations are expected to expand. Design and execution of operations under the innovation and efficiency initiative will be closely coordinated within ADB, with the active involvement of the Risk Management Unit.

Governance and capacity development are key challenges. Sound development management practices need to be further developed, and the institutional and human capacities to deliver results urgently need upgrading. ADB has provided substantive support for capacity building through technical assistance operations and loans, especially to develop local government capacity, and this will continue under the CSP. Anticorruption efforts have been supported through a series of technical assistance projects, and will be further mainstreamed in program and project operations.

The Government is now taking a stronger lead in coordinating with external agencies, which are aligning more fully with Government priorities. Funding agency coordination was strong in response to the tsunami emergency, with a focus on fiduciary governance and anticorruption efforts. Harmonization around policy dialogue has made important progress in recent years, prompted by the Government's reform programs for the investment climate, infrastructure, and the financial sector.

In recent years, decentralization and corruption have made ADB operations in Indonesia resource intensive. The expanded role of program lending requires sustained dialogue in the country. Staff strength in ADB's regional and private sector departments may be sufficient now, but more resources may be necessary at the resident mission, which also leads in emergency response.

Several risks apply to implementation of the proposed CSP. Reforms being undertaken by the Government may draw opposition from those wedded to the dominance of state enterprises or with strong private sector interests. Public and parliament will need persuading of the longer term benefits of many changes that have short-term costs. Natural disasters and a change in the security environment may continue to occupy Government energies and forestall investment. Continued weak public sector management and further delays in clarifying the decentralization policy, and a failure to adjust skills within ADB, may impact on delivery of the program.

Indonesia is critically poised in its pursuit of poverty reduction, growth, and mitigation of vulnerabilities. It can go forward if it chooses boldness of vision, pragmatism, and a commitment to continuous reform. This CSP is designed to support the Government in its choice to address the key development constraints with realism and determination. The consolidation of reform initiatives in recent years and the start of a new program of investments in social and physical infrastructure should ensure that Indonesia is on the path to high growth by 2009.

I. CURRENT DEVELOPMENT TRENDS AND ISSUES

1. Indonesia is the world's largest archipelago and has an ethnically diverse population of 221 million. It has considerable natural resources (timber, fish, petroleum, natural gas, and a variety of metals) and biodiversity. Following rapid growth and declining poverty in the early 1990s, the country witnessed a sudden deterioration of its gross domestic product (GDP) and heightened poverty in 1997–2000, owing to the Asian financial crisis. Consequently, the decades-old authoritative, centralized decision-making system gave way to a democratic and decentralized one, giving civil society a significant voice. The crisis also exposed lack of coordination among different levels of government, and endemic corruption. Although growth since the crisis has been moderate and poverty has declined, there is mixed progress in achieving the Millennium Development Goals (MDGs) (Appendix 1, Table A1.1), with many districts lagging behind.

2. Indonesia is at a critical juncture. Proactive policies are needed to reduce the still relatively high poverty level of 17.8%. Development policy must achieve growth rates of around 7.0% annually to create the jobs needed to mitigate unemployment, now at 10.4%. Substantial investments in infrastructure are needed, with the private sector as an important potential partner. Reforms, including an improved investment climate and a more responsive financial sector, must continue to encourage private sector participation. The country needs to boost its development spending and to strengthen institutional and human capacities to attain the MDGs by 2015.

A. Political Setting

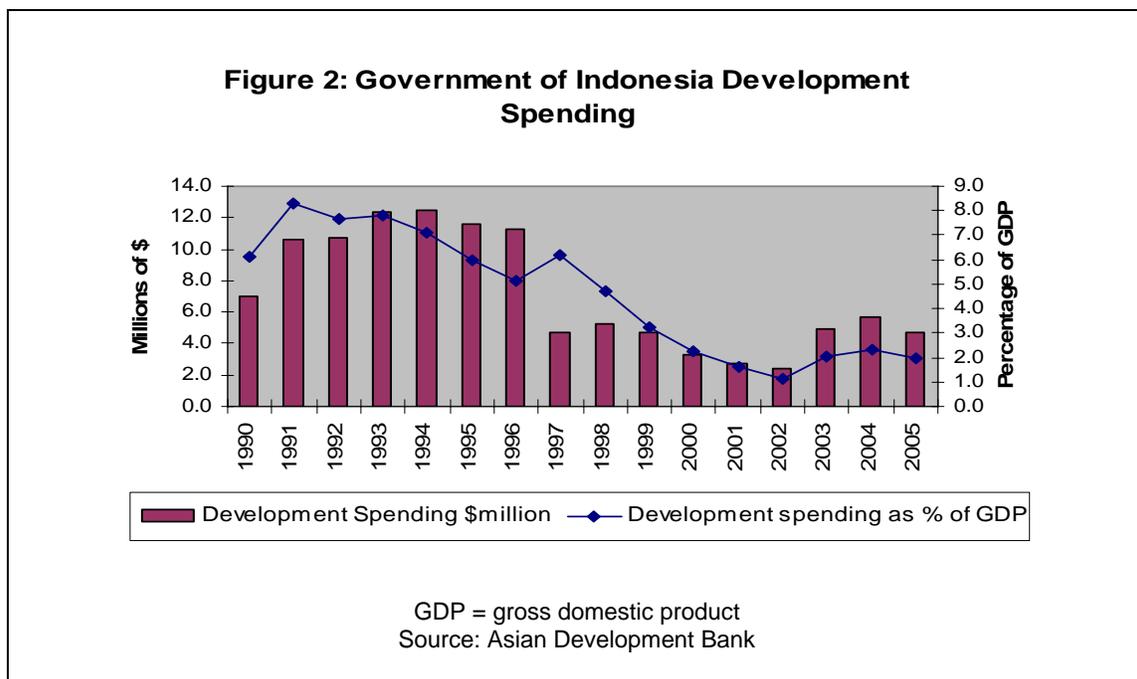
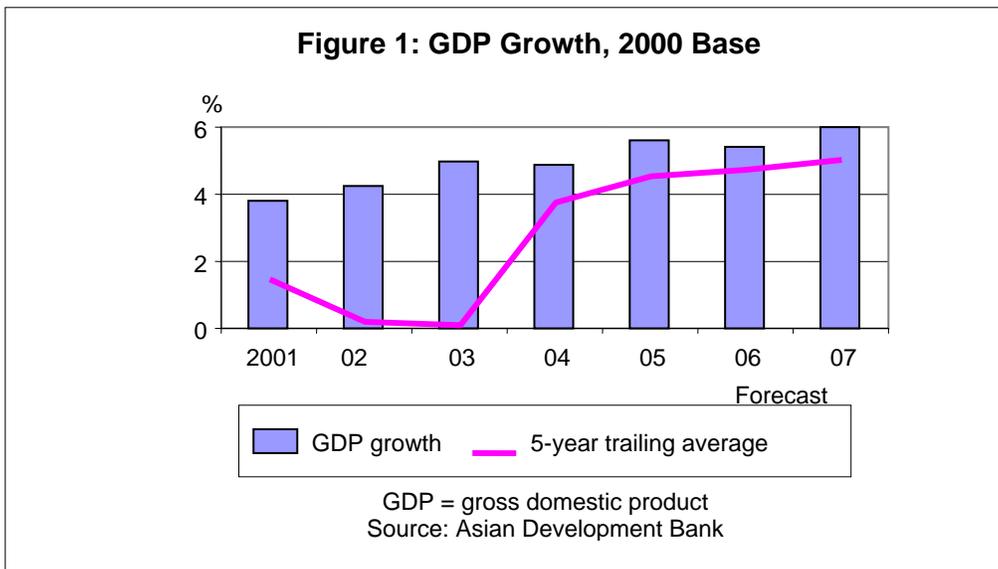
3. There have been four governments since the crisis. The present Government took office in October 2004 after the first-ever direct presidential elections. Earlier that year, direct elections were held for all 550 members of parliament. The Government is coalition-based and legislation can sometimes be protracted.

4. A comprehensive reform program has commenced, including substantial decreases in fuel subsidies in March and October 2005. The Government initiated a major anticorruption drive and launched infrastructure reforms beginning with the Indonesia Infrastructure Summit in January 2005. Investor confidence is rising. However, job creation remains an issue, as does the decline in real wages and an increase in the incidence of poverty. An activist Parliament and strong vested interests from the pre-crisis period may delay reforms.

5. The decentralization initiative of 1999 was unprecedented in scope and scale. Although considerable political autonomy was devolved, it was not preceded by strengthening of the capacities of local governments. Functions between different levels of government are still unclear, and funding allocations do not follow the assignment of functions. Much work remains to be done in this area.

B. Economic Growth

6. Fiscal consolidation has made considerable progress. Real GDP growth steadily rose from 0.8% in 1999 to 5.6% in 2005 (Figure 1); the overall budget deficit declined from around 4.0% of GDP to 0.5%. The Government also reduced its outstanding debt stock from over 100% of GDP to 46.2%. However, higher levels of growth are still elusive because of fiscal constraints, lack of investments, and declining competitiveness, among other factors.



7. A major concern is that the gradual post-crisis economic recovery has largely been consumption driven, and it has occurred without a significant revival in public and private sector investment or significant job creation. In 1996, investments were almost 30% of GDP, with public investment at 7%. By 2000, private sector investment had fallen to 16%, recovering from a low of 13% in 2003 and rising to an estimated 17% in 2006. Public sector investment in 2000 fell to 4% of GDP, where it still was in 2005. The opportunity cost of not supporting development

has been high. Development spending has been low¹ and has not shown any signs of revival since the crisis (Figure 2); it stood at \$3 billion in 2005. Health spending in particular has been under 3% of the budget, while education spending amounts to 6% of the budget (against the 20% mandated by the Constitution). Before the crisis, infrastructure spending amounted to 5% of GDP (\$10 billion per year, including \$2 billion from the private sector). Now, infrastructure spending is only 2% of GDP and is mainly focused on maintenance.

8. Development spending by regional governments has been slowly increasing from a low base, but remains inadequate to meet social and infrastructure needs. As a consequence, Indonesia lags behind some of the other comparable southeast Asian economies in secondary school enrollment, under-5 mortality, maternal mortality, and access to improved sanitation.² There are still about 50 million people without access to treated water, 90 million people without electricity, and close to 200 million people without direct access to telecommunications or connections to a sewerage network. The poor suffer disproportionately from the lack of access to such basic infrastructure services.

9. Unemployment has seen a steady increase, as growth was not sufficient to absorb the 2 million new entrants to the job market each year, and now stands at 10.4%. Historically, annual economic growth of 4–5% was thought to be sufficient to absorb new entrants. Evidence shows that in 1998–2004, growth stemmed in part from a steady rise in labor productivity. It is now estimated that the economy would need to grow by 7% annually to absorb all new entrants.³ At the same time, the gap between wage growth and productivity growth in manufacturing has increased from –3.5% before the crisis to over 27.0% in 2000–2003, given rapid increases in the average minimum wage.⁴

10. Indonesian competitiveness declined sharply after 2000 because of inadequate infrastructure, lack of skills, poor investment climate, and a weak financial sector. In September 2006, the *Doing Business* report⁵ shows that in being business-friendly, Indonesia's ranking was 135 out of 175 countries, as compared with 131 in 2005, and behind Thailand (18), Malaysia (25), the People's Republic of China (93), Viet Nam (104), and the Philippines (126). At a broader level, looking at competitiveness, the picture is mixed.⁶

11. Recent Government initiatives to promote economic growth are promising. While the removal of fuel subsidies led to a spiraling of inflation to above 18% in October 2005 and is likely to result in slower growth in the short term, it has reduced a major distortion in the economy. As a result, the Government is estimated to have generated a "fiscal space" of about \$5 billion in 2005 and about \$10 billion in 2006. The Government launched one of the largest

¹ Development spending includes investments, and recurrent expenditures in some categories, as well as defense spending. Starting 2005, a unified budgeting system was introduced at the national Government level, eliminating the distinction between development and recurrent expenditures.

² For example, secondary school enrollment stood at 62% in Indonesia in 2004 relative to 77% in Thailand and 74% in Viet Nam; under-5 mortality was 38 per 1,000 births in Indonesia, against 21 in Thailand and 23 in Viet Nam; maternal mortality was 230 per 100,000 live births, compared to 44 in Thailand and 111 in Viet Nam; and access to improved sanitation was 52% in Indonesia against 99% in Thailand. Source: Global Monitoring Report 2006, UNDP.

³ World Bank. 2006. *Investing for Growth and Recovery*. Jakarta.

⁴ 49% in 2000, 24% in 2001, and 38% in 2002. Minimum wages are set by regional governments and vary across the country.

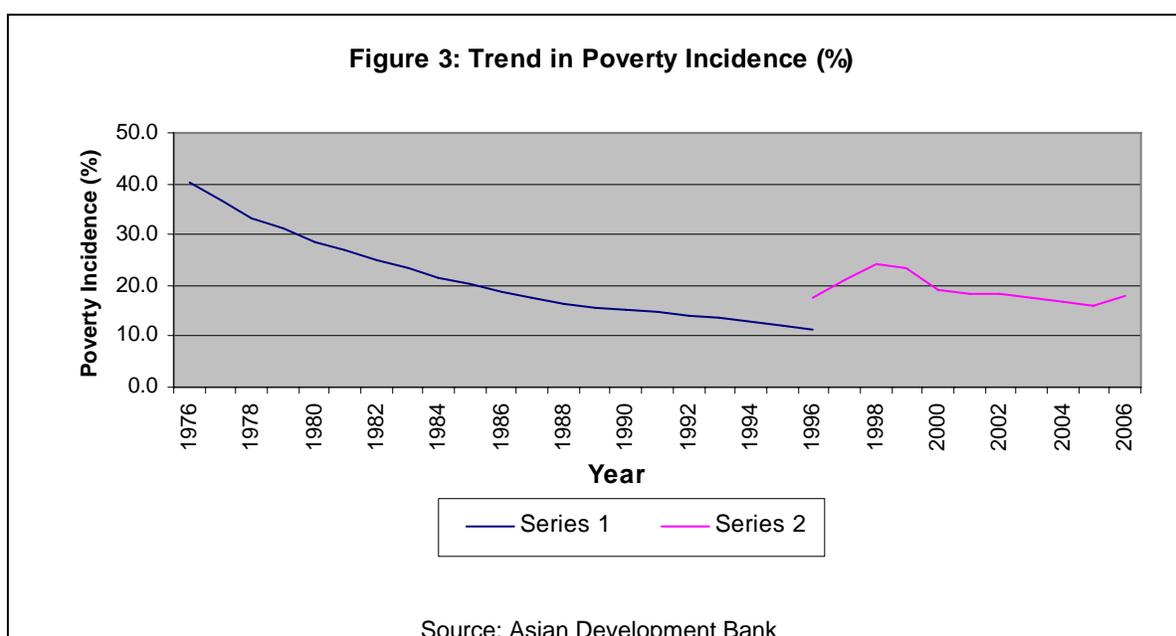
⁵ World Bank and International Finance Corporation (IFC). 2006. *Doing Business*. Washington, DC.

⁶ World Economic Forum. 2006. *Global Competitiveness Report 2006*. Geneva. Indonesia ranked 50 out of 125 countries in 2006, compared with 74 in 2005 and 69 in 2004.

cash transfer programs by targeting 15.5 million poor households to receive about \$32 per household per quarter. It has also scaled up health and education spending programs.

C. Poverty

12. The Asian Development Bank's (ADB) country poverty analysis⁷ shows that the poverty incidence had declined to 16.7% in early 2005 (Figure 3). In March 2006, however, it had increased again, to 17.8%, following the effects of the fuel subsidy reductions in 2005. About 39.5 million people live below the poverty line. More than 50% of the population lives below \$2/day and is highly vulnerable to shocks at all levels—micro or household (such as an illness in the family), meso or local (such as a natural disaster), and macro or national (such as an increase in fuel prices). Causes of poverty include lack of access to health, education, safe water, housing, sanitation services, and an absence of economic opportunities, compounded by the lack of infrastructure in isolated areas with difficult geography and poor market linkages. Nearly one out of five rural villages is inaccessible even by four-wheel-drive vehicles for part of the year.



D. Governance, Decentralization, and Institutional Capacity

13. Indonesia does not as yet have an administration and a judiciary entirely ruled by law, and a market economy based on open competition.⁸ The civil service is unmotivated, poorly paid, and unskilled.⁹ Most public institutions finance a significant proportion of their operations from revenues that are not registered in the budget. The police, courts, auditors, national and regional government agencies, and even schools are not able to operate on their formal budgets alone, which leads to seeking off-budget sources. The Government's capacity to

⁷ ADB. From Poverty to Prosperity: A Country Poverty Analysis for Indonesia. Forthcoming. Manila. A summary is in Appendix 6.

⁸ ADB. 2004. *Country Governance Assessment, Indonesia*. Manila.

⁹ "Government" includes the central, provincial, city, and district governments.

prepare projects well and to coordinate project preparation and implementation among various agencies is not well developed.

14. Public expenditure management is central to combating corruption. Law 17/2003 on State Finance consolidates a budget previously split into routine and development parts, and promotes performance-based evaluation of budgetary outcomes. It also stipulates new financial reporting standards in accordance with new public sector accounting standards. Similarly, Law 1/2004 on the State Treasury provides for budget management and financial planning, and debt and property management, and stipulates a consolidated treasury single account. It also has clear provisions for deterring fraud, mismanagement, and corruption. Thus, a strong legal framework for public expenditure management in accordance with good international practice is in place, but full implementation will take time.

15. Since 1999, a number of anticorruption laws have been enacted: Law 28/1999 on Creating a State that is Free of Corruption, Collusion, and Nepotism; Law 31/1999 on Eradicating Criminal Acts of Corruption; Law 15/2002 on Eradicating Money Laundering; and Law 30/2002 on Establishment of the Commission for Eradication of Corruption. A range of state auxiliary bodies have been established, with mandates to fight corruption. These include the KPK, the National Ombudsman Commission, the National Law Commission, and the Commission for the Eradication of Money Laundering. Fighting corruption has a prominent place in the reform agenda of the Government and the President. While comprehensive anticorruption legislation has been in place for several years, it was only during 2005 that serious enforcement began.

16. The speed and complexity of decentralization has left considerable gaps and inconsistencies in the policy framework.¹⁰ Moreover, the number of local governments has increased substantially to 33 provinces and 450 districts. Under Law 32/2004 on Regional Autonomy, the number of obligatory functions is 16 but the division of responsibilities among levels of government is unclear. The major funding source for local governments is the General Allocation Fund, a block grant determined by a formula¹¹ not by need. Some local governments also get revenues through a mechanism for sharing of revenues from natural resources. Law 32/2004 has significantly improved accountability of regional governments. The new accounting standards to be introduced under Law 17/2003 on State Finance will further strengthen accountability but will take time before they have the desired impact.

17. The human and institutional capacity of local governments to deliver high-quality and responsive services is weak. While the regions have been provided with more autonomy, they have inherited a civil service that is not entirely aligned with local priorities. This is aggravated by the fact that there is no system to transfer civil servants between regions.

E. Private Sector

18. There were large inflows of foreign capital into the oil, gas, and mineral sectors in the 1970s and 1980s despite the obligation to adopt production-sharing contracts and other restrictive regulations. Liberalization of the banking, insurance, and retail distribution sectors led

¹⁰ Seven laws, 9 Government regulations, 5 presidential decrees, and 22 ministerial regulations are concerned with planning, budgeting, accounting, financial reporting, and accountability for the national and local governments. About 30 new regulations and decrees are being considered under Law 32/2004 on Regional Autonomy and Law 33/2004 on Regional Fiscal Balance.

¹¹ The formula's variables include population, geographic area, building price index, and level of poverty.

to increased foreign direct investment in the years leading up to the financial crisis of 1997/98. With the onset of the financial crisis and the Government's assumption of much of the country's productive assets as part of the wholesale restructuring of the banking sector, the share of the private sector in GDP is estimated to have fallen to 30% in 2000 from 75% in early 1997. Subsequent rounds of privatization from 2001 to 2004 have transferred an estimated \$39 billion in assets to the private sector, restoring its pre-crisis proportion of GDP.

19. Despite the strong presence of the private sector, the public sector is one of the largest in the region, with over 130 state-owned enterprises (SOEs), some dominating key sectors such as banking, ports, airports, energy, and oil and gas. Despite their size and monopoly positions in selected sectors, SOE profits represent less than 5% of total Government revenues.¹² About 55% of total SOE revenue and net income in 2002 were concentrated in the top five SOEs. SOEs receive preferential market access from the Government in many sectors, crowding out private sector competitors. In a number of important infrastructure sectors, SOEs perform operational and regulatory roles at the same time.

F. Gender Assessment

20. The multi-agency country gender assessment¹³ identified four key themes through a consultative process: (i) the impact of decentralization on gender, (ii) women's inadequate representation in political decision-making, (iii) violence against women, and (iv) women and international migration. It noted that while Indonesia has made progress over the years, inequalities persist. Gender-disaggregated data is lacking. However, the gender development index in 2003 was 87 compared with the human development index of 110. Women's longer life expectancy is more than offset by a much lower literacy rate and a small share of earned income; in 2003, women's labor force participation was only 40%, compared with 79% for men. While the enrollment ratio of girls to boys in both primary and secondary education favors girls, the share of women in wage employment in the non-agricultural sector has declined, as has the proportion of seats held by women in the national parliament. Women's health is of particular concern in Indonesia, which has one of the highest maternal mortality ratios in the region. Poverty, unemployment, and a lack of formal education drive increasing numbers of women to migrate overseas. Official migrants have been complemented by unofficial migrants (an estimated 60% of Indonesian workers in Malaysia are thought to be unofficial), who are highly vulnerable, with no guarantees for tenure, minimum wages, or good working conditions. The shift to regional autonomy has already shown potential for increased participation of women in local governance, but decentralization has sometimes been accompanied by a revival of conservative religious interpretations of gender roles.

G. Civil Society

21. Over the last 6 years, the number of civil society organizations (CSOs), including nongovernment organizations (NGOs), has increased. CSOs often serve as facilitators, educators, and organizers in such initiatives, and are also involved as participants in decentralized planning and as service providers in several sectors. Social services are frequently being delivered by CSOs, which also provide valuable feedback to the Government on how services are meeting community needs. CSOs (including labor unions, religious

¹² Revenues are defined as net profit of the SOEs distributed to the ministry. The profitability of SOEs is distorted by the noncommercial activities they are often required to perform.

¹³ ADB. 2006. *Country Gender Assessment: Indonesia*, Asia Foundation, ADB, Canada International Development Agency, National Democratic Institute, and World Bank. Manila.

organizations, foundations, and institutes) have helped raise public awareness of women's rights, indigenous peoples, worker rights, and environmental protection. CSOs also promote higher standards of probity and responsible use of budgetary resources in the public sector by identifying, documenting, and pursuing suspected cases of corruption, and by raising public awareness of the negative impacts of corrupt practices. In a number of projects, NGOs have been assisting ADB with project design and implementation, and have been consulted for the country strategy and program (CSP),¹⁴ and during previous programming missions.

H. Environment

22. Indonesia's rich environment and natural resources have been a significant asset. However, the pressure on resources is damaging most natural systems. Deforestation and unsustainable forestry management have led to environmental degradation. There is a lack of clarity over responsibilities of different levels of government, tenure and access related to the rights of the communities and the role of private enterprises, and legal enforcement. Coastal resources are under pressure owing to open access to resources, and lack of an integrated framework for coastal resource protection. Water resource management is essential to meet growing demand. It is hampered by institutional weaknesses in river basin management, weak water pollution control measures, lack of a framework for water allocation and pricing, and problems in maintaining and operating water infrastructure, including water supply and irrigation facilities. Several regions face risks of floods and low water quality.

23. Industrialization and increasing population have worsened environmental pollution, particularly in urban and peri-urban areas. Pollution of surface water, contamination and depletion of groundwater, air pollution, and improper and illegal disposal of solid and hazardous wastes from residential and industrial sources are serious. Several air pollutants in the largest cities exceed ambient air quality standards. Industrial waste, estimated at 0.25 million tons in 1990, reached over 1.20 million tons in 2001. About 80% is hazardous. Environmental laws and regulations are poorly enforced. Investments in urban sewerage and waste treatment have been inadequate.

24. The environmental legal framework has evolved over the past two decades and, in general, meets international standards.¹⁵ However, some of the laws and regulations still need to be adapted to the decentralized policy setting, under which the responsibility for natural resource management rests with district governments.

I. Regional Cooperation

25. Indonesia is a founding member of the Association of Southeast Asian Nations (ASEAN) and also of two subregional cooperation initiatives: the Brunei Darussalam, Indonesia, Malaysia, Philippines-East ASEAN Growth Area (BIMP-EAGA); and the Indonesia, Malaysia, Thailand-Growth Triangle (IMT-GT).¹⁶ ASEAN's commitment to and progress toward a single market in Southeast Asia represents real potential for the Indonesian private sector to secure economies of scale from a market of more than 500 million people. At the subregional level, Indonesia and its neighbors share an archipelagic geography. Almost all major islands of Indonesia, with the

¹⁴ See Appendix 2 for a description of the CSP process.

¹⁵ ADB. 2005. *Country Environment Assessment Indonesia*. Manila.

¹⁶ BIMP-EAGA includes Brunei Darussalam; Kalimantan, Sulawesi, Maluku, and Irian Jaya in Indonesia; Sabah, Sarawak, and Labuan in Malaysia; and Mindanao and Palawan in the Philippines. IMT-GT comprises eight provinces each in southern Thailand and Peninsular Malaysia, and all provinces in Sumatra in Indonesia.

exception of Java, are covered under subregional cooperation initiatives for BIMP-EAGA or IMT-GT. Indonesia would benefit significantly by strengthening its capacities in subregional cooperation which, given its geographical and archipelagic spread, would simultaneously contribute to improved national integration.¹⁷ BIMP-EAGA and IMT-GT, founded in the early 1990s, seek social and economic development of less developed and more remote territories through cooperation in trade, investments, and tourism. Following economic recovery from the 1997 crisis, regional governments, including Indonesia, have reaffirmed the importance of and their commitment to both initiatives, and are seeking to revitalize and refocus them. As a key development partner, ADB is facilitating this process by helping both initiatives enhance results-oriented implementation of their respective road maps.

J. Development Constraints

26. The Government's objective is to reduce poverty through economic growth with job creation and accelerated attainment of the MDGs. The crisis raised awareness of the risks associated with a growth-oriented development agenda without a strong financial sector. Constraints on macroeconomic progress have been more clearly identified. The Government's capacity to manage risk and invest, however, has been questioned. The Government now needs to guide a development process led by a more autonomous private sector. A greater separation of government policy and private interests involves establishing new legal and regulatory structures, and directly addressing governance issues in the public and private sectors. Decentralization has tested capacities to manage functions at the local levels, and to monitor and manage decentralized processes at the center. Main constraints on development are discussed below.

27. **Adverse Investment Climate.** While Indonesia's markets have been open to foreign investment for many years, and trade tariffs are among the lowest in the region,¹⁸ the country is not attractive for investment. Of concern to domestic and foreign investors are the absence of a stable and coherent legal, regulatory, and fiscal framework; the proliferation of local regulations and taxes; the dominance of SOEs in some key sectors; systemic corruption; and a weak dispute-resolution mechanism. These weaknesses are compounded by inadequate physical infrastructure and infrastructure services and underdeveloped financial markets.

28. **Poor Physical Infrastructure.** Indonesia has some of the lowest electrification and tele-density rates in the region, low levels of piped water and sanitation access, and increasingly congested national and provincial road networks. While infrastructure received high levels of private and public investment in the decades before the crisis, investment has fallen precipitously since. About \$65 billion in new investment is needed to increase the growth rate from 5.5% to 7.6% over 2005–2009.¹⁹ The Government may be able to contribute \$25 billion or about 39%. Restoring private participation in infrastructure is necessary to close the financing gap but requires fundamental restructuring of the sectors. The Government's role will mainly be as regulator and facilitator, to plan and undertake institutional and policy reforms, to manage regulatory and other risks discouraging private investment, and to improve inter-ministerial coordination.

¹⁷ ADB technical assistance is helping build capacity in the National Secretariat for Subregional Cooperation in Indonesia (INO TA 4555).

¹⁸ Average tariff rate is 7%.

¹⁹ Government of Indonesia. 2006. *Infrastructure Reform Package*. Jakarta. Investment covers power, roads, telecoms, water and sanitation, port and airport modernization, and excludes irrigation.

29. **Underdeveloped Financial Sector.** After the crisis, the Government closed down many banks, reducing their number from over 240 to about 135 currently. The banking sector improved: nonperforming loans are lower, capital-adequacy ratios higher, and banks more profitable. However, banks still dominate the financial landscape, accounting for 80% of financial assets. The sector is highly concentrated, with the three largest state-owned commercial banks controlling over half the banking system assets. The Government has focused on the legal and regulatory framework covering both banks and nonbank financial institutions (NBFIs), as well as the development of capital markets. However, NBFIs are small for a country of Indonesia's size.

30. **Inadequate Decentralized Capacities.** A key weakness is in local administrative, technical, and managerial capacity. The laws devolving significant authority to the district governments almost doubled the local government share of total public spending, from about 17% in 2000 to more than 30% in 2003. About 2 million civil servants were transferred from the national to the local level. The speed and complexity of decentralization has left gaps and inconsistencies in the policy framework. The new laws do not resolve all issues relating to assignment of expenditures, many of which have been left to a supporting regulation now under preparation. Sector laws have conferred many functions on national line ministries while the basic services are delivered at the local level. Public service staff numbers are sufficient overall by regional standards but adequate staff skills are limited—a situation worsened by the rapid increase in number of districts from 230 in 2000 to 450 today.

31. **Weak Natural Resource Management.** Many natural resources are at risk or under stress: inadequate management and overexploitation have triggered resource depletion and environmental degradation. Since exploitation of natural resources constitutes a major source of local revenue (Laws 32/2004 and 33/2004), short-sighted, quick overexploitation may prevail over long-term sustainable management through incentives that discourage long-term development, and inadequate enforcement of existing laws and regulations.

32. **Low Development Spending.** Development spending has been low since the financial crisis as the Government focused its fiscal policy on maintaining macroeconomic stability. Development spending by regional governments²⁰ has been almost nonexistent. This policy stance has successfully reduced the stock of public debt (down to 45.0% of GDP at the end of 2005) and created sustainable budget deficits (0.5% of GDP in 2005). The Government aims to have a balanced budget by 2009. However, the policy stance may have become a constraint on high-quality economic growth. World Bank projections²¹ of declining budget deficits, a further reduction in debt stock, and a further gradual reduction in fuel subsidies show development expenditures increasing to 5–6% of GDP, excluding defense, by 2009. The Ministry of Finance (MOF) is preparing amendments to relevant decrees to specify onlending requirements and procedures for intermediation of foreign loans by the national Government to local governments.

33. **Weak Public Sector Management.** Too many regulations are of low quality, which nurture corruption, burden citizens, distort markets, and raise costs. A new law²² regulates law preparation, but it focuses too much on the administrative and legal process and not enough on ensuring substantive consistency between laws. Lack of effective consultations with

²⁰ Beginning with financial year 2003, local governments were required to prepare financial reports in accordance with Ministry of Home Affairs Decree 29. The new format differs significantly from the old, particularly for expenditure classifications. The discontinuity limits comparisons between 2003 and earlier data.

²¹ World Bank. 2005. *Economic and Social Update*. Jakarta.

²² Law 29/2005 on the Preparation Process of New Laws.

stakeholders within and outside the government, including business associations and NGOs, leads to difficulties in enforcement and reduced compliance. Budgetary under-funding of state institutions is a cause of poor performance and corruption. Public institutions have larger expenditure obligations than budgets. Most finance a significant proportion of their operations from revenues that are not registered in the budget. Apart from financial resources, a number of capacity assessment exercises (including the sample taken for the ADB-financed Sustainable Capacity Building for Decentralization Project),²³ and a study by the German Agency for Technical Cooperation (GTZ) and the United States Agency for International Development (USAID)²⁴ have indicated a wide range of human resource needs, including strategic planning, financial management, and human resource management.

II. THE GOVERNMENT'S DEVELOPMENT STRATEGY

A. Development Goals and Strategy

34. The Government has formulated the Medium-Term Development Plan (RPJM)²⁵ for 2005–2009, which focuses on poverty reduction through higher growth rates with job creation and environmental sustainability, and activities and investments to achieve the MDGs. It has identified five priority areas to achieve its goals: (i) job creation and poverty reduction programs; (ii) macroeconomic stability with stable prices, fiscal sustainability, and financial sector reforms; (iii) accelerating investments, exports, and tourism through reforms for a healthy business climate and flexible markets; (iv) improved access to and quality of education and health; and (v) infrastructure development by improving the efficiency of existing services and greater private sector participation. Poverty reduction strategies are becoming increasingly localized; local governments are encouraged to set up poverty reduction committees and develop their own strategies. Most recently, the Government announced that the community-driven development²⁶ and conditional cash transfer²⁷ programs would become the cornerstone of poverty reduction.

35. The RPJM targets halving the percentage of those below the poverty line to 8.2% by 2009 through programs to improve food security, water supply and sanitation, access to basic health and education services, and shelter. The macroeconomic targets by 2009 include an increase in economic growth from 5.5% to 7.6%, and a reduction in open unemployment from 9.7% in 2004 to 5.1%. The plan projects an increase in school enrollment rates, especially in the 9-year mandatory basic education program, to over 99% in 2009, and better education. It also projects a significant increase in enrollment in secondary and tertiary education, and a reduction in illiteracy to 5%. The plan targets an increase in life expectancy from 66.2 to 70.6 years, a decline in infant mortality from 35 to 26 per 100,000 live births, a decline in maternal mortality from 307 to 226 per 100,000 live births, and a reduction in malnutrition among children under 5 from 26% to 20%.

²³ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan and Technical Assistance Grants to the Republic of Indonesia for the Sustainable Capacity Building for Decentralization Project*. Manila (Loan 1964-INO, approved on 10 December for the amount of \$42.22 million).

²⁴ GTZ and USAID. 2000. *Development of National Capacity Building Framework under Decentralization*. Jakarta.

²⁵ Presidential Regulation 7/2005 on the National Medium-Term Development Plan issued on 19 January 2005.

²⁶ The approach gives control over planning decisions and investment resources for local development projects to community groups.

²⁷ A form of targeted social protection that aims to reduce current and future poverty by providing cash benefits to poor families contingent on their making investments in human capital: for example, by sending children to school or taking them to health stations.

36. The Government aims to reduce debt to 31.8% of GDP by 2009 by maintaining a conservative fiscal stance. At the end of 2005, public foreign debt was \$65.6 billion, combined domestic and foreign debt was 47% of GDP, debt servicing requirements over 2004–2005 averaged 25% of the overall budget, and 144 loan-funded projects under implementation had an undisbursed balance of \$8.3 billion. The Government has embarked on a program of loan cancellations,²⁸ debt swaps in the case of bilateral loans, and more prudent borrowing for new projects.

37. Achieving good governance is a key element of the Government's vision, and the medium-term plan. The Government has recently started formulating a plan to reform and strengthen the civil service. A comprehensive reform program was started in various institutions such as the taxation, immigration, and customs offices. Recent Ministry of Finance restructuring created the Fiscal Policy Office and the Debt Management Office to continue strengthening public financial management, public audit, and local financial management.

B. Resource Mobilization and Investment

38. Fiscal resources are constrained by high debt service requirements, and unproductive subsidies. Yet, by aiming for a balanced budget by 2009, resources to boost development spending are potentially available. By reducing fuel subsidies in 2005, the Government attempted to increase its resources. A compensation program has used the freed-up resources to accelerate the achievement of the MDGs. However, spending has not picked up, partly because of anticorruption measures. Line agencies and local governments are investing Government funds in short-term financial instruments rather than for growth and MDG acceleration. Local governments remain dependent on fiscal transfers from the national Government, which have increased from Rp33.5 trillion (\$3.98 billion) in 2000 to Rp129.7 trillion (\$13.2 billion) in 2004.

C. Role of External Assistance

39. Since 2000, the Government has reduced its external borrowing and, consequently, the level of external assistance has been declining.²⁹ Official pledges at the Consultative Group for Indonesia³⁰ slid from over \$7.0 billion in 1998 to about \$3.5 billion in 2006. The transfer of public sector obligations to local governments has further discouraged borrowing as the Government has been operating without an effective mechanism to channel official development assistance to local governments. Lending by the World Bank and ADB in support of policy reforms has been of significant value to Government budget management. Recently, external assistance has been directed at policy and thematic support, local governments and communities, and emergency, rehabilitation and reconstruction activities for large-scale disasters. As part of the Paris agenda to harmonize and align external assistance, the Government has been streamlining its foreign assistance procedures. External agencies have increasingly harmonized around priority themes to engage the Government in policy dialogue.

²⁸ ADB cancelled \$450 million in project loans and \$50 million in program loans over 2003–2005.

²⁹ Grant financing of official development assistance constitutes less than 5% of the total.

³⁰ The 15th Consultative Group for Indonesia was held on 14 June 2006.

D. ADB's Assessment of the Government's Development Strategy

40. The RPJM is a comprehensive document that analyzes problems and offers solutions. Constraints on development are stated clearly. The RPJM has ambitious macroeconomic, poverty, and sectoral targets, many of which can be achieved provided the key constraints of weak governance, low economic growth, and weak capacities are addressed. Recognizing that macroeconomic and sector reforms will be vital to attract greater private sector investments, the Government has begun to articulate its short- and medium-term reform agenda in the investment climate, infrastructure, and the financial sector. The reform program needs to clarify the now overlapping roles and functions of the myriad government institutions to make the civil service more accountable and more responsive to private sector initiatives. Implementing such a program will take time. Appendix 3 provides an assessment of the Government's capacity to manage for results.

III. ADB'S DEVELOPMENT EXPERIENCE

A. Past Assistance

41. Indonesia remains one of the largest recipients of ADB's lending and technical assistance (TA). From about \$5 billion in the 1980s, public sector lending commitments to Indonesia rose to \$11 billion in the 1990s. Following the crisis, lending to Indonesia gradually dropped. During 1998–2005, 43 loans were approved, totaling \$6.2 billion, with 11 (26%) program loans totaling \$3.73 billion, and 32 (74%) project loans for \$2.48 billion for 27 projects. There was a significant turnaround in 2005, when public sector approvals reached \$798 million from a low of \$225 million in 2004. From 1998 to 2005, lending operations saw an increase in program loans to advance policy reforms; more decentralized projects; and the provision of limited access to Asian Development Fund (ADF) resources to support human development projects, including capacity development (Table 1). Cofinancing of \$273 million was mobilized from Canada, Japan, the Netherlands, and the United Kingdom.

42. Indonesia has also been one of the largest beneficiaries of TA. From 1990 to 2005, ADB approved \$127 million for 122 advisory TA projects and \$76 million for 135 project preparatory TA projects. Following the financial crisis, TA operations have become more focused on supporting the Government's reform agenda. Several TA projects financed by the Japan Fund for Poverty Reduction have also been provided, including five to support tsunami-related emergency operations. From 2000 to 2006, TA operations benefited from \$25 million in cofinancing from Australia, Canada, Denmark, the European Commission, France, the Netherlands, and the United Kingdom.

43. ADB's private sector operations in Indonesia began in 1985 with a \$1 million line of credit and a \$0.4 million investment loan to the Development Bank of Indonesia. Later, approvals totaled \$169 million until the onset of the crisis led to a break in ADB's private sector operations in Indonesia. At the end of 2004, outstanding principal in the private sector portfolio amounted to \$17.4 million.³¹ In December 2005, a \$350 million private sector loan, the largest to date by ADB, was approved to help develop the Tangguh liquefied natural gas (LNG) field in

³¹ Mostly a nonperforming loan to a manufacturing company. The defaulting borrower has recently indicated its agreement to repay its debt, albeit at deep discount.

Irian Jaya Barat.³² In 2006, further operations were approved for motorcycle securitization and for a gas pipeline.³³ Recent macroeconomic performance and commitment to ongoing policy reforms augur well for expanded private sector operations.

Table 1: Public Sector Lending Commitments by Sector, 1998–2005
(\$ million)

Sector	ADF	OCR	Total
Agriculture and Natural Resources	208	158	366
Education	100	180	280
Energy	0	321	321
Finance	0	97	97
Health, Social Protection, and Nutrition	100	465	565
Industry and Trade	20	153	173
Law, Economic Management, and Public Policy	55	3,730	3,785
Transport and Communications	0	343	343
Water Supply, Sanitation, and Waste Management	31	34	65
Multisector	92	120	212
Total	606	5,601	6,207

Source: Asian Development Bank.

44. ADB has a sound track record in supporting good governance. ADB has provided support for anticorruption measures, including procurement reforms, during the last 5 years. A number of ongoing loan-funded activities have an anticorruption and capacity-building focus. The Governance and Anticorruption Road Map in Appendix 4 provides details. More broadly, program loans under preparation have substantive governance and anticorruption dimensions. ADB has also actively supported the Partnership for Governance Reform.

45. The Sustainable Capacity Building for Decentralization Project is developing capacities of local governments. The State Audit Reform Project is strengthening all provincial and selected district government internal audit functions. The Local Government Finance and Governance Reform Project is supporting capacity building for public financial management in at least 50 districts. Other ongoing loans have capacity-building components or have a capacity-building TA attached.

46. Indonesia is prone to natural disasters, and emergency operations have increased recently. Following the tsunami and earthquake that hit Aceh and Nias in late 2004, ADB

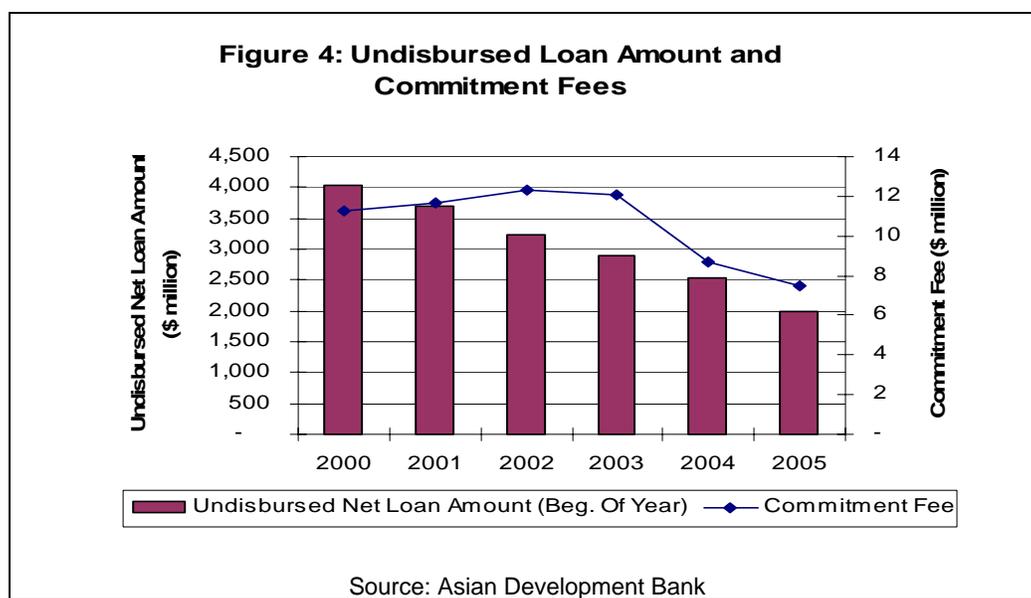
³² ADB. 2005. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to the Republic of Indonesia for the Tangguh Liquefied Natural Project*. Manila (approved on 14 December 2005, for \$350 million). ADB financing catalyzed \$2.9 billion in loans from other sources.

³³ ADB. 2006. *Report and Recommendation of the President to the Board of Directors for Financing and Partial Credit Guarantee Acquisition and Securitization of Motor Loan Portfolios by Deutsche Bank AG*. Manila (Loan 7239-INO, approved on 26 July 2006 for \$10 million); ADB. 2006. *Report and Recommendation of the President to the Board of Directors on Private Sector Loan to PT Perusahaan Gas Negara (PGN) for the South Sumatra to West Java Phase II Gas Pipeline Project*. Manila (approved on 10 August 2006 for \$75 million). ADB financing catalyzed \$125 million in loans from other sources.

approved \$300 million grant assistance for rehabilitation and reconstruction.³⁴ Following the earthquake in Yogyakarta and Central Java in May 2006, ADB has offered \$10 million in grant assistance for reconstruction.³⁵ Given Government preference for grant funding to respond to natural disasters, the use of loan funds reprogrammed for Aceh and Nias has been slow.

B. Portfolio Performance and Status

47. Continued efforts by the Government and ADB have helped improve the ongoing portfolio and reduce undisbursed balances (Figure 4). The undisbursed net loan amount decreased from about \$4.0 billion at the beginning of 2000 to below \$1.7 billion at the beginning of 2006, 40% of the 2000 level. Commitment fees declined accordingly, from \$11 million–\$12 million per year during 2000–2003 to below \$8 million in 2005. During 2000–2005, 68 loans were closed while 31 new loans were approved (Figure 5). Annual cancellations were 4–8% of the net undisbursed loan amount at the beginning of each year, in line with prudent project administration.

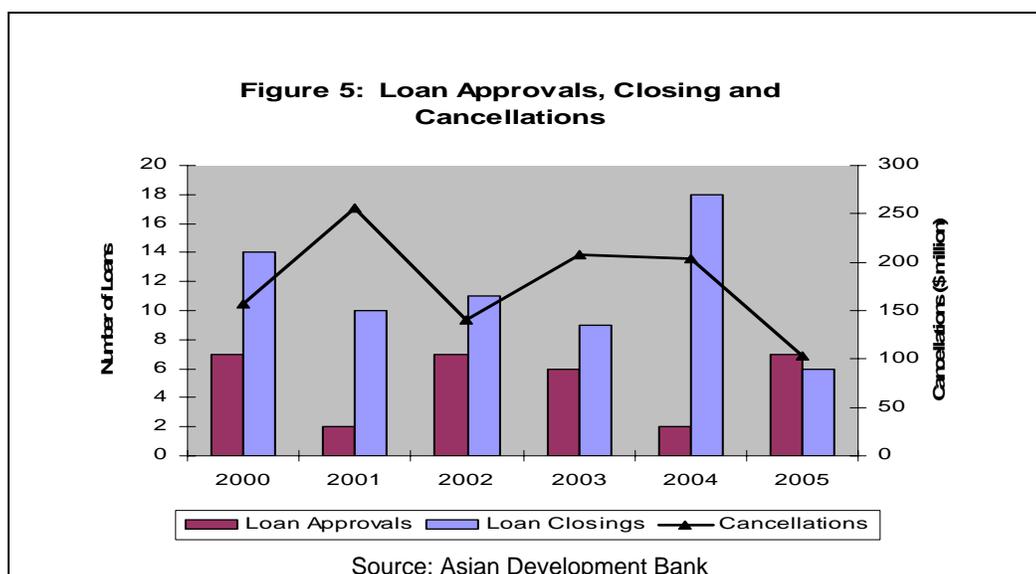


48. Portfolio performance has substantially improved over the last few years. All projects are currently rated satisfactory for implementation progress, and for achievement of development objectives. No projects are at risk³⁶ but problems persist. Start-up delays are caused by late loan effectiveness, long lead times to establish project management and implementation offices, and delayed recruitment of consultants. These are exacerbated by the late release of counterpart funds, procurement delays, weaknesses in the executing agency, and unfamiliarity with ADB procedures. ADB's safeguard policies and the Government's approach to safeguard issues still need to be reconciled through active coordination in the field. All of these issues will continue to be resolved at the project, sector, and country levels.

³⁴ ADB. 2005. *Grant to Republic of Indonesia for Earthquake and Tsunami Emergency Support Project*, Manila (0002-INO, approved on 7 April 2005, for \$290 million, plus a \$10 million contribution to the Multidonor Fund for Aceh and Nias Reconstruction).

³⁵ Report on Yogyakarta-Central Java Earthquake Disasters, IN:122-06, circulated 31 May 2006.

³⁶ Projects rated by ADB as only partly satisfactory, unsatisfactory, or with potential problems in their implementation progress or the likelihood of achieving their development objectives.



C. Lessons Learned

49. The recent country assistance program evaluation³⁷ (CAPE) and operational experience based on the 2002 country strategy and program (CSP 2003–2005) have provided considerable lessons.

50. **CAPE.** From 1997 to 2004, the CAPE found a strong congruence between the Government's goals and ADB's strategic objectives.³⁸ ADB remained engaged as the Government struggled with recovery and the transition to decentralization. However, a compromise between multiple agendas, driven both by emerging country realities and ADB's concerns, diluted the impact of ADB's operations. The strategies were too broad and the programs not adequately linked to the strategies. The CAPE recommended that governance be further mainstreamed in ADB operations. It also recommended geographic targeting to reduce transaction costs and increase the sustainability of project outcomes, especially at the local government level. Based on more recent developments, projects and programs should be even better aligned with Government priorities and make maximum use of government systems. A recent example of using government systems is the Rural Infrastructure Support Project,³⁹ where ADB supported an ongoing Government program with additional financing, using existing implementation mechanisms with enhanced monitoring.

51. The CAPE notes that the performance of ADB's projects and programs has fluctuated over the last 15 years but has markedly improved recently. The agriculture sector is the least successful, with more than 20% of projects rated unsuccessful. Performance is mixed elsewhere. Energy projects—transmission, distribution, and energy development—generally have been rated successful as have transport and communications projects. Financial sector projects and programs have also generally performed well. Multisector projects have primarily

³⁷ ADB. 2006. *Country Assistance Program Evaluation*. Manila.

³⁸ ADB. 2000. *Country Operational Strategy*, Manila, and ADB. 2002. *Country Strategy and Program*. Manila.

³⁹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the Rural Infrastructure Support Project*. Manila (Loan 2221-INO(SF), approved on 19 December 2005 for \$50 million).

focused on urban development and have been highly rated. Education, especially basic and secondary, projects are among the most successful. Health projects show a slightly more mixed performance.

52. As recommended by the CAPE, the CSP analyzes development constraints and focuses support on removing them in key areas. CSP coverage is aligned with available resources and capacities, both in the ADB as well as in the Government. Increased use of country systems as capacities are being developed will be one way to reduce transaction costs. A matrix showing how the CAPE recommendations and subsequent comments by the Development Effectiveness Committee have been addressed in the CSP is in Appendix 2.

53. **CSP 2003–2005.** Operations over the last 3 years were governed by the CSP for 2003–2005, discussed by the Board in November 2002.⁴⁰ Many delays have been encountered in implementing the 3-year lending program. The processing of new projects became more challenging for several reasons, including the impact of decentralization, lack of coordination between agencies, and weak institutional and human capacities. ADB's loan products were increasingly seen as outdated, with high transaction costs. Of the 11 loans in the 2003 program, 2 were approved in that year, 3 were approved in subsequent years, 3 are still under processing, and 3 were dropped.

54. The design and implementation of decentralized projects tests the capacity of both the government system and ADB. The projects under implementation involve some 200 districts. ADB lacks adequate resources for project supervision and monitoring, and results are difficult to measure. ADB and other agencies have invested heavily in capacity development but results have sometimes been disappointing. A fresh approach needs to be explored to better target long-term capacity development, including more Government involvement in TA design and implementation and in consultant recruitment, and the use of the more flexible TA cluster.

D. Conclusions and Lessons for the Country Strategy and Program

55. ADB has been responsive to the needs of the Government but was unable to adjust quickly enough to the new realities of decentralization. ADB should work increasingly through existing Government systems in support of Government programs, and with and through other development partners that have the capacity to work effectively at the local levels. The crisis and subsequent democratization and decentralization process have diluted capacities within line agencies and at the local level. The new strategy needs to recognize that ADB's lending and nonlending products may no longer be as effective and that new approaches are needed.

IV. ADB'S STRATEGY

A. Summary of Key Development Challenges

56. Indonesia's principal challenge remains in reducing poverty and eliminating the vulnerability of large sections of the population. The Government must achieve higher levels of sustainable economic growth, improve public sector management, boost development spending, and accelerate the achievement of the MDGs. Improving the investment climate, investing in infrastructure, and deepening the financial sector are necessary to improve

⁴⁰ ADB. 2002. *Indonesia Country Strategy and Program 2003–2005*. Manila.

competitiveness and increase economic growth. Strengthening institutional and human capacities at all levels is needed to deliver the development agenda and improve social service delivery. Improving natural resource management will decrease the population's vulnerability to increased poverty.

B. The ADB Strategy for Indonesia

57. Indonesia must adopt pragmatic yet bold policy measures to ensure that economic growth is efficient, sustainable, and equitable in a decentralized environment. Recent policy actions have demonstrated the Government's resolve to work toward this end. To pursue the Government's twin goals of sustainable economic growth and MDG achievement, ADB's strategy is designed around two pillars and a key thematic concern. Table 2 summarizes the main development constraints that need to be addressed in support of these two pillars. The strategy uses this framework to identify five areas of long-term engagement based on these constraints. The main purpose of the CSP is to support the Government in addressing these constraints.

Table 2: Goals and Constraints

Goals:	Pro-Poor, Sustainable Economic Growth	Social Development
Constraints	Adverse investment climate	Weak decentralized capacities
	Poor physical infrastructure	Weak natural resource management
	Underdeveloped financial sector	
	Low development spending	
	Weak public sector management	

Source: Asian Development Bank.

58. The proposed CSP for 2006–2009 is aligned with the Government's goals and priorities for the RPJM, which ends in 2009. It is consistent with ADB's long-term strategic framework.⁴¹ It includes a focus on capacity development, introduced as a thematic priority in ADB's enhanced poverty reduction strategy.⁴² It is consistent with the strategic priorities of the medium-term strategy II (MTS II),⁴³ including catalyzing investments, strengthening inclusiveness, managing the environment, and improving governance and preventing corruption.

59. **Pillar I: Pro-Poor, Sustainable Economic Growth.** ADB will help the Government raise levels of economic growth by catalyzing public and private sector investments. Support will be provided through a combination of macroeconomic, infrastructure, and financial sector reforms; selective project investments in infrastructure; and capacity development. Private sector investments will continue to focus on catalytic initiatives, thereby stimulating private sector development and encouraging private sector investment.

60. **Pillar II: Social Development.** ADB support will focus on a more sustainable, transparent, and equitable fiscal decentralization to provide local governments with the means to improve the quality as well as the volume of service delivery. This will ensure effective use of the fiscal space created by private sector investment in infrastructure, as well as the continued

⁴¹ ADB. 2001. *The Long-Term Strategic Framework of the Asian Development Bank (2001-2015)*. Manila.

⁴² ADB. 2004. *Review of the Asian Development Bank's poverty reduction strategy*. Manila.

⁴³ ADB. 2006. *Medium-Term Strategy II, 2006–2008*. Manila.

reduction in unproductive subsidies. Support will be provided to policy and institutional reform, selective expenditure programs and investments, resource management, and capacity development. To enhance livelihoods and ensure sustainable development, attention will be paid to marine and urban environment issues. The management of water resources will play a prominent role consistent with ADB's water financing initiative.

61. **Key Thematic Concern: Governance and Anticorruption Efforts.** All ADB operations will involve activities to strengthen national and subnational governance by promoting institutional development and strengthening capacities for improved public sector management. In the case of non-sovereign lending to SOEs, corporate governance issues will be addressed. ADB program loans will continue to include substantial governance components. Support will also focus on promoting anticorruption efforts and accountability for improved fiscal and administrative accountability of regional governments and enhanced fiduciary governance.

C. Strategic Areas of Engagement

62. ADB will engage the Government in five operational areas derived from the analysis of constraints on development, corresponding to five of the seven constraints identified in section I. The areas of engagement also take into account some key targets of the Government's RPJM, and reflect lessons from ADB's operational experience (Table 3). The expected outcomes associated with these areas of engagement can be summarized as follows:

- (i) improved infrastructure and infrastructure services, including rural infrastructure, with increased public and private sector investment, and improved sector regulation as indicators;
- (ii) deepened financial sector, with improved domestic resource mobilization to meet long-term financing needs as the indicator;
- (iii) improved decentralization, with increased regional spending and enhanced financial reporting as indicators;
- (iv) accelerated MDG achievement, with better water supply and sanitation, health, and education indicators; and
- (v) strengthened environment and natural resources management, with enhanced water and marine resources management and reduced pollution as indicators.

Areas (i) and (ii) are expected to help leverage much greater private sector participation. Areas (iii), (iv), and (v) in combination are expected to enhance the quantity and quality of public service delivery. Engagement in these areas will be selective, and reflect the priorities of ADB's MTS II as well as those of the Government. The key thematic concern with governance and fighting corruption will have reduced corruption as the key outcome indicator.

D. Operational Considerations

63. **Use of Innovative Modalities.** ADB will provide program lending using clusters of single-tranche operations. These will be embedded in the Government's medium-term reform agenda, requiring continual dialogue on priorities and actions with Government and other development partners. The Government has welcomed this approach as it has the flexibility to adjust the program and its speed of implementation according to country developments. ADB will use the multi-tranche financing facility (MFF) in a number of activities to ensure long-term, sustained sector engagement to combine investments with subsector policy improvements and to provide the opportunity to combine public sector sovereign lending with non-sovereign and private sector operations. Cluster TA projects will be used to support policy reforms and

investment in the areas of engagement. The Government's medium-term reform agenda will help create the conditions for more effective project lending. Project lending is expected to shift over time from public sector operations to non-sovereign lending and public-private partnerships, including guarantee facilities where appropriate.

Table 3: Strategic Focus for ADB Operations in Indonesia

Constraints	RPJM Targets	Lessons from ADB Operations		CSP Areas of Engagement	
Underdeveloped physical infrastructure	Invest \$65 billion in infrastructure	<ul style="list-style-type: none"> Weak capacity (to design and execute projects) Vested interests (preventing PPPs) Budgetary constraints Good ADB performance 	Leveraging private sector participation	Infrastructure and infrastructure services	Governance
Lack of depth in the financial sector	Private financing of infrastructure	<ul style="list-style-type: none"> Post-crisis reforms inadequate to achieve greater diversification ADB long-term support for regulatory reforms Support to be translated to achieve faster market and product development 		Financial sector deepening	
Low decentralized capacities	Regional governments that are effective, efficient, and accountable	<ul style="list-style-type: none"> Conflicting incentives at national and decentralized levels Need for long-term engagement Policy reform to be infused with actual implementation support 	Augmenting quantity and quality of public sector services	Decentralization	Governance
Low development spending	Increase access to quality water supply, health, and education services	<ul style="list-style-type: none"> Fiscal system inequitable and inefficient Distortionary tariff policies and incentives Complex onlending/granting arrangements 		MDG acceleration	
Weak natural resources management	Integrated and sustainable management of water resources	<ul style="list-style-type: none"> Weak local Government capacities Weak coordination between levels of Government 		Environment and natural resource management	

PPP = public-private partnership

Source: Asian Development Bank

64. **Private Sector Development.** Private sector operations will focus on infrastructure and finance sectors in particular (Appendix 5), including potential lending to state enterprises that are financially viable and need not rely on government guarantees, in the context of sector reforms and improved corporate governance. The design and execution of public and private sector projects under the innovation and efficiency initiative umbrella will be closely coordinated so that ADB's resources are used efficiently. More broadly, private sector development will be integrated into all ADB operations to the extent possible, given the lead role of the private sector in job creation. This will happen through the reform programs to establish new legal and regulatory regimes, governance operations to improve public sector management and directly address corruption, and specific measures to enhance audit and procurement processes.

65. **Poverty Focus.** The CSP combines a range of interventions that will support the sustainable reduction of poverty and vulnerability. Prioritizing investments in human capital (education and health) and in physical capital (infrastructure services) will promote economic growth, create jobs, and reduce poverty. Support to accelerate MDGs will focus on prioritizing and reorienting public expenditure toward health (including nutrition) and education, and on improving the quality, efficiency, and effectiveness of social service delivery. Fiscal decentralization will empower local governments through more efficient expenditure management, while support for the Government's community empowerment programs will enable a more inclusive approach to development. Support for improved disaster risk management will reduce the vulnerability of the poor and the near-poor.

66. **Sector and Subsector Selectivity.** Sector and subsector selectivity has been derived from (i) lessons learned from prior operations, (ii) the Government's objectives and priorities, (iii) the overall outcomes and intermediate outcome indicators in line with the Government's targets, and (iv) partnerships with other development agencies. It is also in line with MTS II. Unlike under the previous CSP, ADB will not provide new public sector lending for airports, fisheries, credit lines to SMEs, nonformal education, technical and vocational training and skills development, agriculture production, agriculture research, land rehabilitation, housing finance, or credit lines for microfinance. ADB will play a key role in activities listed as group-I priorities of the MTS II through program lending operations to enhance infrastructure reforms, deepen the financial sector, improve Government MDG expenditure programs, and enhance air quality. ADB will continue to play a key role in education, energy, and roads. It will support some activities listed as group-II priorities, including water supply and sanitation, rural and regional infrastructure, and coastal resources management (Table 4). The number of potential subsectors for lending will be reduced from 26 under the previous CSP to 16.

67. **Capacity Development and TA Operations.** ADB will continue to mainstream capacity development in its operations. During the CSP, \$95 million in already approved capacity development loans will be implemented in addition to the many capacity development components in new and ongoing loan-funded projects. In the past, ADB took a short-term approach⁴⁴ to TA resource allocation. Cluster TA projects will be adopted for the sustained and flexible provision of advisory and capacity-development support. The CSP proposes the adoption of at least four TA clusters in support of the areas of engagement.⁴⁵ The objectives and scope will be medium term and align with the RPJM and CSP priorities.

⁴⁴ Other funding agencies have had 4–5-year long-term trust funds or other upfront allocation mechanisms that provide for continuity and flexibility.

⁴⁵ Poverty reduction, MDG acceleration, and social sector strengthening; investment climate, finance, and policy reform; physical infrastructure development; and governance and fighting corruption.

Table 4: Country Strategy and Program Operations

ADB Proposed Operations (2006–2009) ^a	MTS II Sector Prioritization
A. MTS II, Group I^b	
<ul style="list-style-type: none"> • Regional Roads 	<ul style="list-style-type: none"> • Road Transport
<ul style="list-style-type: none"> • Energy Efficiency 	<ul style="list-style-type: none"> • Energy
<ul style="list-style-type: none"> • Water Supply, Sanitation, and Waste Management • Integrated Settlements • Neighborhood Upgrading 	<ul style="list-style-type: none"> • Urban Infrastructure (water supply, sanitation, waste management, and urban transport)
<ul style="list-style-type: none"> • Rural Infrastructure • Community and Local Government Support • Water Supply and Sanitation • Water Resources Management • Flood Management 	<ul style="list-style-type: none"> • Rural Infrastructure (roads, power, irrigation, and water management)
<ul style="list-style-type: none"> • MDG Acceleration Program • Secondary and Madrasah Education 	<ul style="list-style-type: none"> • Education
<ul style="list-style-type: none"> • Financial Sector Reform Program • Secondary Mortgage Market 	<ul style="list-style-type: none"> • Financial Sector
B. MTS II, Group II^c	
<ul style="list-style-type: none"> • Coastal Resources Management • Urban Air Quality 	<ul style="list-style-type: none"> • Agriculture and Natural Resources (except fishery, livestock, irrigation, and water management)
<ul style="list-style-type: none"> • MDG Acceleration Program • Nutrition Improvement 	<ul style="list-style-type: none"> • Health
<ul style="list-style-type: none"> • Development Policy Support Program • Infrastructure Reform Program • Local Government Finance Reform Program 	<ul style="list-style-type: none"> • Public Finance and Economic Management

^a The lending program includes the Sustainable Aquaculture for Food Security and Poverty Reduction Project and the Interisland Ports Projects, which do not fit in group I or II but are in an advanced state of preparation. The two projects were listed in the CSP update of 2005.

^b Group I includes ADB's core operational sectors.

^c Group II includes ADB's non-core operational sectors.

Source: Asian Development Bank

68. Governance and Fighting Corruption. ADB will continue to support governance initiatives through lending and TA operations to improve financial management at decentralized levels, public expenditure management, audit, and procurement. An important dimension of governance is local institutional and human capacity. ADB will continue to provide support through its decentralized operations. Harmonizing its efforts with other funding agencies, ADB will continue policy dialogue support to improve decentralization policies and practices.

69. Mainstreaming Gender. ADB will identify at the earliest stages of project design the possible positive and negative impacts on both men and women. As a matter of good practice, ADB will collect data on both project implementers and beneficiaries disaggregated by gender. Projects will include target-setting and support for women to reduce disparities between men and women. ADB will support raising public awareness of the importance of women as stakeholders of development efforts, promote women's representation in public decision-making, and encourage women to engage in local planning and budgeting.

70. **Regional Cooperation and Integration.** The RPJM advocates a proactive approach to regional cooperation. Regional cooperation initiatives have the strong potential to assist in overcoming persistent and pervasive poverty in isolated regions of the country. ADB will help BIMP-EAGA and IMT-GT enhance implementation of their respective road maps and promote increased participation of private sector in regional infrastructure investments. The IMT-GT road map identifies enhanced connectivity corridors both within Sumatra and across the Straits of Malacca. Development of these corridors potentially enhances linking Java with mainland Asia, with strong potential growth impact in the longer term. In BIMP-EAGA, ADB is helping coordinate efforts to harmonize customs, immigration, quarantine, and security (CIQS) rules, regulations, and procedures, and helped establish a CIQS task force with representatives from participating countries. ADB will help plan development projects that have Indonesian national and regional significance, including transport, energy, trade facilitation, tourism, environmental management, and other regional public goods. Recent examples of regional public goods supported by ADB include enhancing cooperation among Southeast Asian equity markets,⁴⁶ developing standards for Islamic financial services,⁴⁷ supporting responses to communicable diseases,⁴⁸ and proposing trade cooperation in Southeast Asia. The Office of Regional Economic Integration will continue supporting ASEAN economic integration through (i) facilitation of regional policy dialogue of ASEAN economic and finance ministers; and (ii) capacity building and institutional development for ASEAN member countries on issues related to trade, investment, money, and finance. Indonesia is a direct beneficiary and active partner of ADB in these activities.

71. **Disaster Management.** Disaster management could significantly reduce costs if risk reduction strategies were incorporated into development projects. Following the Government's objective to develop a proactive disaster risk reduction framework, ADB will provide policy and advisory support and incorporate hazard management techniques into relevant projects. Two proposed projects in particular—the Integrated Citarum Water Resources Project and the Flood Management in Selected River Basins Project—have been identified for the use of such techniques, adding to new practices being developed in Indonesia.

72. **Partnering and Harmonization.** ADB will continue to work closely with the Japan Bank for International Cooperation (JBIC) and the World Bank to harmonize the policy dialogue with Government, especially for macroeconomic and infrastructure reforms. Collaboration in portfolio management and procurement will also intensify. ADB will further harmonize its anticorruption efforts with those of other funding agencies and the Government. Coordination among funding agencies is increasingly successful in supporting the Government's decentralization efforts. ADB will continue to work closely with the World Bank, the Australian Government's Overseas Aid Agency (AusAID), the Netherlands, the European Commission, the Department for International Development of the United Kingdom (DFID), CIDA, GTZ, and other funding agencies to generate cofinancing. Finally, ADB will prepare its loans in full accordance with the Government criteria for project readiness to minimize start-up and physical implementation delays.

⁴⁶ ADB. 2005. *Technical Assistance for Supporting Enhanced Cooperation among Southeast Asian Equity Markets*. Manila (TA 6298-REG, for \$500,000, approved on 22 December).

⁴⁷ ADB. 2006. *Technical Assistance for Development of International Prudential Standards for Islamic Financial Services*. Manila (TA 6182-REG, for \$400,000, approved on 27 July).

⁴⁸ ADB. 2006. *Technical Assistance for Strengthening Epidemiological Surveillance and Response for Communicable Diseases in Indonesia, Malaysia, and Philippines*. Manila (TA 6305-REG, for \$1.2 million, approved on 18 January).

V. ADB'S ASSISTANCE PROGRAM

A. Overall Assistance Level

73. Indonesia, a group-B2 country, is eligible for a blend of ordinary capital resources (OCR) and ADF borrowing. During the CSP 2006–2009, OCR public sector lending is expected to increase gradually from \$550 million in 2006 to about \$1 billion in 2009, with fairly consistent levels of program lending, and increased project lending. Actual levels of OCR lending will be determined by Government needs, the availability of well-designed projects, including private sector and non-sovereign operations, and the willingness to borrow in the context of the Government's borrowing strategy. The allocation of ADF to Indonesia is \$200 million per 2-year period. As in the past, ADF will be primarily used for direct poverty-related interventions and capacity development.

74. Non-sovereign lending is expected to occur during the CSP, but time will be needed to address specific related issues. For example, current legislation does not allow local governments to directly borrow from international financial institutions. There are opportunities for non-sovereign lending to SOEs, but risk-sharing arrangements need to be sorted out in each case. The Government is interested in the MFF as it would help institutionalize project-readiness criteria, and lessen the burden of annual borrowing commitments. Several SOEs and private sector enterprises have expressed interest in local currency lending. ADB is working with the Government to prepare for ADB's first local bond offering. ADB will continue to step up its private sector investments, loans, and guarantee products.

75. ADB will sharpen the focus of its TA program in line with CSP priorities. Commitments will remain at about \$12 million–\$15 million per year but with fewer operations. The advisory TA program will focus on providing policy dialogue and technical support for the strategic areas of engagement, in the form of larger cluster TAs. ADB will remain proactive in securing cofinancing from bilateral partners for its TA operations.

76. **Cost-Sharing Arrangements.** Until the introduction of the new cost-sharing policy,⁴⁹ ADB's cost-sharing limit was set at 70% for ADF and OCR loans for Indonesia as a group-B2 country. The TA cost-sharing limit was set at 80%. For this CSP, the cost-sharing limit will remain at 70% for loans and at 80% for TA projects. The new policy includes the possibility to finance certain expenditures, including land acquisition, and taxes and duties among others. The Government considers that these need to be financed from the budget, and that borrowing foreign currency for them would not be justified (Appendix 6). Cost-sharing will be monitored through the annual portfolio review process.

⁴⁹ ADB. 2005. *Cost Sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*. Manila (R193-05, August).

B. ADB Assistance for Strategic Priorities

1. Pro-Poor Sustainable Growth

a. Infrastructure and Infrastructure Services

77. The Infrastructure Reform Program cluster, with three subprograms over 2006–2010, will be the main vehicle to help develop infrastructure and infrastructure services. Its objective is to strengthen the investment climate and thereby achieve an average annual growth of 6–7%. Its expected outcome is accelerated infrastructure development through private sector participation and additional public sector investments.⁵⁰ Through a related project preparation facility, the program will enable a strong pipeline of infrastructure projects in energy and power development, roads, and urban infrastructure for possible ADB financing from 2008 onward. It will facilitate the use of ADB's instruments, including innovation and efficiency initiative products, private sector investments, and guarantee facilities, of special value to mobilizing financing for public-private partnerships, possibly in conjunction with other development partners. The provision of guarantee support will be based on Government's risk-sharing frameworks.

78. Energy efficiency⁵¹ is a priority to meet demand growth in Indonesia as it has the highest energy intensity in the region (about 30% more than Thailand and Malaysia). The main target areas are loss reduction in the existing power distribution network and promotion of efficient use of energy by end customers (demand-side management). These initiatives would immediately benefit the country by reducing oil-based generation. In 2007, ADB will support an energy efficiency project covering the whole of the State Electricity Company of Indonesia (Perusahaan Listrik Negara [PLN]) distribution system in the Java–Bali grid, which comprises Greater Jakarta and Tangerang (Jakarta), West Java and Banten (Bandung), Central Java and Yogyakarta (Semarang), East Java (Surabaya), and Bali (Denpasar). The project will allow PLN to deliver electricity from the existing generation network over the existing distribution network more efficiently.

79. To help maintain and develop the skills to support economic growth, ADB will finance the Senior Secondary Education Project in 2007. Other projects will directly help develop infrastructure facilities, including the Regional Roads Development Project in 2009. ADB will continue to support development of rural infrastructure, an area unattractive to the private sector, through the Rural Infrastructure Support Project II. These efforts will support job creation and social development by helping provide basic infrastructure to the poor and disadvantaged in remote and isolated villages, empowering communities to prioritize their infrastructure needs and to plan and implement the works. An integrated approach to site development, service provision, and urban renewal is being prepared through the Integrated Settlements Development Project (2008), designed for the urban poor.

b. Financial Sector Deepening

80. Support will be continued for the Government's financial sector reform program. The focus will be on strengthening supervision of nonbank financial institutions, including the

⁵⁰ The reforms included in the program cluster relate to the legal, policy, and institutional framework for transportation (roads, ports airports, and railways); power; oil and gas; telecommunications; and water supply and sanitation.

⁵¹ ADB recently announced the second phase of its energy efficiency initiative, which focuses on designing and implementing renewable energy and energy efficiency projects, to make energy development in Asia environmentally and economically sustainable.

insurance and pension fund industries, and development of the capital market. This will be through the second and third Financial Governance and Social Security Reform programs (2007 and 2009). Support will also be provided to develop the secondary mortgage market through the Secondary Mortgage Facility Project. It is proposed as an MFF from 2007, combining public sector lending and non-sovereign and guarantee operations. Support to deepen financial sector will be provided through a cluster TA operation.

c. Development Policy Support

81. A series of program lending operations is being prepared in conjunction with the development policy loans (DPLs) of the World Bank, which support the Government's broad-based, cross-cutting medium-term investment climate and governance reform agenda. The first DPL was approved by the World Bank in 2004. Through 2004, ADB provided parallel support to the DPL agenda through financial sector and SOE reform programs. In 2005, at the Government's request, ADB provided parallel cofinancing to DPL operations through the Development Policy Support Program I (DPSP I).⁵² The second tranche of the DPSP is being formulated for approval in 2006. Subsequent phases of the DPSP during the CSP will be designed in close collaboration with the Government, the World Bank, and the Government of Japan. The World Bank's DPLs and ADB's DPSP provide the framework for broad macroeconomic and institutional reforms and the context for deeper sector reforms, while avoiding overlaps. Specific areas where ADB will be particularly engaged through policy dialogue and direct involvement include prudent fiscal management; enhanced corporate governance in the banking sector and enhanced regulatory framework for nonbank financial institutions; movement toward an investment registration system to reduce the need for approvals, with a transparent negative list; and treasury and audit reforms.

d. Private Sector Operations

82. Private sector operations will selectively support the development and financing of important infrastructure projects in energy; transport; and urban water supply, sanitation, and waste management. Private sector projects will be selected if they have a strong demonstration effect, are innovative and pioneering, and are replicable by ADB and others in Indonesia and elsewhere. ADB would expect to provide direct loan financing to projects on a project-finance basis but is also seeking opportunities to fund infrastructure investment through non-guaranteed corporate lending to sub-sovereign companies where these entities have some element of private ownership or demonstrate a high degree of management autonomy, with financial transparency, high standards of corporate governance, and a commercially based management philosophy. Given the levels of appetite of international commercial banks for Indonesian sovereign risk, ADB would expect its political-risk guarantee product to play an important role in ensuring the successful financing of privately sponsored projects. Finally, provision of long-term local currency financing could play an important role for privately sponsored infrastructure projects, especially those with local currency revenues.

83. Investments by PSOD can promote savings and better allocate and intermediate financial resources. Potential operations include support for better regulation and supervision of financial markets, bond market development, development and enhancement of mortgages,

⁵² ADB. 2005. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for Development Policy Support Program*. Manila (Loan 2228-INO, approved on 21 December 2005 for \$200 million).

securitization, assistance to non-finance companies, and innovative financing for infrastructure. ADB's support to deepen financial markets will also include possible non-sovereign lending to SOEs, municipal entities, and financial institutions; issuance of local currency bonds to provide local currency funding for projects; and the promotion of a rupiah bond market. PSOD will explore opportunities in the financial sector, such as (i) provision of a financial intermediation loan to a local SME bank or to a nonbank finance company catering to SMEs (such as a leasing company); (ii) asset-backed securitization (domestic and cross-border) as a means of structured debt financing through the capital market; and (iii) debt capital market development such as ADB's support to issuance of corporate bonds, which might face difficulties on a stand-alone basis, through credit enhancements via a partial credit guarantee or liquidity facility.

2. Social Development

a. Decentralization

84. ADB will continue to support the Government's decentralization agenda through policy reforms and capacity development. Through follow-up activities to ongoing support for state audit reform and sustainable capacity building for decentralization, ADB will help enhance local public service delivery, particularly for education and water supply and sanitation, in selected provinces and districts. The Decentralization Support Facility (DSF)⁵³ has become an important instrument to align initiatives with Government needs and harmonize policies and interventions with other agencies. The Partnership for Governance Reform now has a strong track record in facilitating progress fighting corruption, decentralization, and civil service and legal and judicial reforms, and will continue to be an important center for reform on all levels of government.⁵⁴

85. Delivery of social services cannot be improved without continuing to develop capacity to strengthen the decentralization framework, putting local government finances on a more sustainable basis, and introducing financial accountability to local governments. Following the Local Government Finance and Governance Reform Sector Development Program in 2005,⁵⁵ further support will be provided through a second program in 2008 to ensure continued momentum of institutional and policy reforms, and to further promote pro-poor and gender-responsive budgeting at local levels.

b. MDG Acceleration

86. Accelerating the attainment of the MDGs is an important part of the Government's RPJM. ADB will support necessary policy and institutional reforms, and investments in specific project interventions. Key support will be provided through the Poverty Reduction and MDG Acceleration Program, a cluster program operation beginning in 2007. The program seeks to help the Government improve the efficiency of public spending and delivery of social services, and the quality and access to social services, to achieve medium-term poverty reduction targets. Many project investments will also support attainment of the MDGs: the Madrasah

⁵³ The DSF was established early in 2005 by ADB, DFID, the Netherlands, UNDP, and the World Bank, and fully financed by DFID. Based on lessons learned, DFID has reviewed and redesigned the DSF in order to make it more effective and get the Government more involved. A second phase of the DSF started in mid-2006.

⁵⁴ *Outcome Evaluation Agenda for Governance Reform in Indonesia, 2000–2005*. Commissioned by UNDP, final report, Jakarta, 5 May 2006.

⁵⁵ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the Republic of Indonesia for the Local Government Finance and Governance Reform Sector Development Program*. Manila (Loans 2192/2193-INO(SF), approved on 3 November for \$330 million).

Education Support Project (2006), the Nutrition Improvement through Community Empowerment Project (2007), the Water Supply and Sanitation Project (2008), the Metropolitan Sanitation Management and Health Project (2009), the Second Community Water Services and Health Project (2009) and the Second Neighborhood Upgrading and Shelter Sector Project (2009). For a description of the first Community Water Services and Health Project see the box below. The Second Community and Local Government Support Project (2008) will invest in infrastructure to tackle rural poverty, and will be designed to further the Government's new community-driven development initiative.

Example of an MDG-Related Project

The objective of the Community Water Services and Health Project^a (combined loan and emergency grant), approved in April 2005, is to enhance the health status of low-income rural communities by improving their hygiene behavior and sustaining their access to safe drinking water and better sanitation. The project has four components: (i) improving the capacity of local governments to facilitate, regulate, and deliver quality services in water and sanitation to the target communities; (ii) strengthening the community capability to design, cofinance, build, operate, and manage community-based water and sanitation facilities; (iii) improving access to water and sanitation services by building adequate facilities based on community demand; and (iv) increasing hygiene awareness through information, education, and communication campaigns. The project will cover about 1,000 communities in 20 districts in the provinces of West Kalimantan, Central Kalimantan, Jambi, and Bengkulu; 400 more communities in Aceh and Nias—North Sumatra are being covered by the Aceh/Nias emergency grant. The project follows a community-driven development approach, where the communities themselves decide on the type of facilities they would like to have in their villages; plan and implement—with the help of community facilitators—community action plans detailing community capacity-building, health and hygiene, and infrastructure activities; manage the funds for community action plan implementation; take charge of operation and maintenance of the infrastructure; and monitor and evaluate the sustainability. Communities are required to demonstrate their commitment by contributing at least 20% of the total community action plan cost (16% in kind, 4% cash, the latter except in Aceh and Nias) and by covering all operation and maintenance costs.

^a Loans 2162 and 2163(SF)-INO, approved for \$65 million on 7 April 2005. Grant 0003-INO: Community Water Services and Health Aceh-Nias and North Sumatra Project, approved for \$16.5 million on 7 April 2005.

c. Environment and Natural Resource Management

87. A key element of ADB operations for environment and natural resource management will be the management of water resources. Support will be provided for integrated water resources management, including investments in infrastructure and management of multipurpose facilities, in a river basin context. Two projects are under preparation. The Integrated Citarum Water Resources Management Project is being developed as an MFF for approval in 2007, with subsequent periodic financing requests in 2009 and after. The project will help implement a strategic road map for development and sustainable management of the Citarum river basin, and thus improve quality and supply of water to the cities of Jakarta and Bandung and to farmers in West Java. The Flood Management in Selected River Basins Project is also being developed as an MFF for approval in 2008, and will focus on selected river basins and improved capacities in Central and West Java.

88. Natural resource management will also be promoted through two other operations. The Integrated Coastal Resources Management Project (2008) will help selected local governments improve coastal resources management and protect the marine environment on which so many depend, as well as marine biodiversity. Support will be provided for reforms and investment

leading to improve urban air quality. The Urban Air Quality Sector Development Program in 2008 will promote the use of clean fuels and a reduction of mobile and stationary sources of pollution.

89. ADB's Water Financing Program (WFP) 2006–2010 prioritizes water as a core business area, and Indonesia is one of its focal countries. The WFP seeks to expand investments in three key areas: rural water services (water supply and sanitation, and irrigation and drainage); urban water services (water supply and sanitation, wastewater management, and environmental improvement); and basin water management (integrated water resource management, including investments in infrastructure, flood management, water quality conservation, conservation and improvement of watersheds, wetlands, and ecosystems). ADB's program of support to Indonesia over 2006–2009 includes operations in each key area of the WFP. This will be the basis for forging long-term partnerships with Indonesia under the Water for All banner, with participation of other funding agencies and civil society.

3. Governance, Anticorruption Measures, and Capacity Development

90. In line with the MTS II and ADB's governance and anticorruption policies,⁵⁶ ADB will focus its operations on public financial management, including clarification of the relative responsibilities and interactions between the three levels of government. This should result in improved fiscal equality between regions, improved efficiency and equality in financing of local governments, effective mechanisms for regional borrowing, development and implementation of performance standards for decentralized functions, capacity building of regional governments, and a gradual expansion of own-revenue sources for local governments.

91. ADB support may cover the Office of the Attorney General, the KPK⁵⁷ and the Supreme Court. This support will focus on prevention as well as improved coordination, supervision, and monitoring capacities. ADB will continue its joint efforts with JBIC and the World Bank to harmonize procurement through an expanded TA for harmonization, and to improve project implementation to reduce corruption in line with the Paris Declaration on Aid Effectiveness.⁵⁸

92. Mainstreaming of capacity development, especially at the local level, will continue to be an important aspect of ADB operations. Several programmed projects have substantial local government capacity development components.⁵⁹ The cluster TA projects will provide capacity building and training at the central and local government levels. Finally, the TA program will provide capacity-building support for water resource management in a decentralized context, disaster risk management, and results management in national planning.

93. ADB supported the most recent country financial accountability assessment⁶⁰ in 2001. With support from other development partners, including the World Bank and AusAID, the assessment was updated during the processing of the DPSP in late 2005. Broadly, Indonesia

⁵⁶ ADB. 1994. *Governance: Sound Development Management*. Manila; and ADB. 1998. *Anticorruption*. Manila.

⁵⁷ An ADB staff member is seconded to the KPK to strengthen its capacity.

⁵⁸ The Paris Declaration on ownership, harmonization, alignment, results, and mutual accountability resulted from the high-level forum organized by the Organisation for Economic Co-operation and Development, Development Co-operation Directorate (OECD-DAC), held in Paris in March 2005.

⁵⁹ Madrasah Education Development Project, Nutrition Improvement and Community Empowerment Project, Poverty Reduction and MDG Acceleration Program, Integrated Coastal Resources Management, and Local Government Finance and Governance Reform SDP.

⁶⁰ ADB and World Bank. 2001. *Indonesia Country Financial Accountability Assessment*. Jakarta.

has introduced significant reforms in fiduciary management, and put in place systems providing adequate oversight on the use of public funds. There are, however, significant implementation challenges that can be effectively dealt with only at the level of individual projects or programs. Through the proposed governance cluster TA (2008), ADB will help the Government undertake a public financial management assessment using the public expenditure and financial accountability framework,⁶¹ to be updated regularly, providing a monitoring tool for both the Government and ADB. This will also address concerns over the transparent use of revenues from extractive industries in support of potential PSOD involvement.

C. External Funding Coordination and Partnership Arrangements

94. The Government has signaled its intention to take a stronger lead in funding agency coordination, to ensure that funding agencies align themselves behind Government priorities, in line with the Paris Declaration. It now chairs Consultative Group for Indonesia meetings. Given the complex environment and capacity issues at central and local government levels, effective coordination of external assistance is essential. Appendix 1, Table A1.5, provides a matrix of funding agency activities in various sectors.

95. Harmonization around policy dialogue activities has made important progress in recent years. The DPSP and the upcoming Infrastructure Reform Program are good examples where major funding agencies have developed and sustained a strong joint policy dialogue with the Government. Another area is for the investment climate, including anticorruption measures and decentralization. Recent experience with the DSF has shown the potential to harmonize and align decentralization. GTZ, CIDA, and AusAID have joined. As DFID is channeling almost all of its funds through the DSF, continued partnership with DFID will focus on poverty reduction by improving decentralized governance, in partnership with other funding agencies. The ongoing partnership with the Netherlands, including cofinancing of ADB operations, will be further strengthened and reoriented to supporting private sector development and investment climate-related initiatives. The partnership with AusAID is being considerably strengthened, initially focusing on education and infrastructure development, with potential for other areas. Continued cooperation with the European Commission in the education and other sectors will be pursued.

96. The role of external assistance in Aceh and Nias in the wake of the December 2004 tsunami has been unique. With unprecedented amounts having been committed by the international community, strong funding agency coordination and supervision has emerged, as well as a strong focus on fiduciary control and anticorruption measures. The experience in Aceh and Nias can have significant lessons for the role and nature of external assistance in general, and for disaster risk management in particular. The approach is being replicated for the Yogyakarta–Central Java earthquake.

D. Indicative Internal Resource Requirements

97. In recent years, decentralization and corruption, among others, have made ADB operations in Indonesia labor intensive. The large number of agencies and offices involved in all projects require continued consultations and follow-up by ADB staff to ensure that projects are moving forward. At the same time, development partners and civil society have also become more active with their own programs. Current staff strength in SERD and PSOD may appear to

⁶¹ A multi-funding agency initiative lead by the World Bank. The assessment will follow. World Bank. 2005. *Public Financial Management Performance Measurement Framework*. Washington, DC.

be adequate to meet the requirements of the proposed program, but some adjustments may have to be made, including possible staff redeployment to IRM. The Government and the development partners and civil society prefer to work with the Indonesia Resident Mission (IRM), given its accessibility and in-house country knowledge. However, since IRM was established in 1987 primarily to help supervise projects, its current resources and skills mix need to be reviewed in light of Indonesia's evolving needs and the MTS II.

VI. RISKS AND PERFORMANCE MONITORING AND EVALUATION

A. Risks

98. **Political Risks.** The Government's program and ADB's support for it are ambitious. Reforming the legal and regulatory environment may be opposed by those with strong private sector interests or wedded to the dominance of SOEs. Reforms with significant long-term benefits but short-term costs are likely to draw public opposition, and active parliamentary review. Maintaining reform momentum will require wide participation and active communication of objectives and potential benefits.

99. **Large-Scale Natural Disasters.** Disasters on the scale of the tsunami that hit Aceh and Nias in December 2004 could have a severe impact if they hit a major economic center. Large-scale disasters stretch the capacity of the Government and slow down decision-making and implementation in many areas of the economy. In cases such as the May 2006 earthquake in Central Java and Yogyakarta, ADB will immediately make available sufficient staff and consultant resources to support Government's damage and loss assessments and help it plan for rehabilitation and reconstruction.

100. **Governance.** Continued weak public sector management could negatively impact on the Government's capacity to deliver. The CSP emphasizes support for reforms that strengthen policy and institutional arrangements for better public sector management in general (through the DPSPs), and in specific sectors (such as infrastructure and finance), coupled with investments in capacity development. The Government may not be able to develop public-private partnerships in infrastructure in a transparent manner and in accordance with international best practices, resulting in a continued lack of domestic and international interest in infrastructure investments. This is the focus of ADB's policy dialogue with the Government in the context of the Infrastructure Reform Program.

101. **Decentralization.** The Government may also not be able to fully implement the decentralization agenda as stipulated in the various laws. Implementing regulations have been delayed and are not always clear. This would affect economic growth in the regions, and threaten the quality of service delivery. ADB's focus is to work with the other funding agencies in the DSF and in the Donor Working Group for Decentralization to have a continuous policy dialogue to advance decentralization and to build capacity.

102. **Portfolio Risks.** ADB anticipates a shift in its assistance to use more of the new financing facilities, including sub-sovereign and private sector operations. These involve a larger risk for ADB operations, and for borrowers no longer accessing Government guarantees. Such operations can be accompanied by specific guarantee operations. SERD and PSOD will work closely with the Risk Management Unit to mitigate such risks.

B. Monitoring Process and Plan

103. This CSP signals ADB's intention to manage its activities more proactively, increase development effectiveness, and achieve sustainable development results. It will contribute to the goals of the RPJM, and specific outcomes, targets, and indicators. Table 5 constitutes a CSP results framework providing a management tool for monitoring and delivering results. The results framework will help (i) monitor progress made during CSP implementation, supplemented by TA and loan reviews and the CSP midterm review; (ii) provide an overall framework for the design of new operations; (iii) update and adjust the assistance program to ensure ADB's contribution to the desired outcomes; and (iv) evaluate the effects of the CSP. The results framework also serves to link ongoing operations to key expected outcomes for update during annual portfolio reviews. The results framework may be periodically updated to ensure its continued relevance, in line with changes in the development setting and management of the ongoing portfolio. Project monitoring frameworks will be linked, through sector road maps, to the delivery of the desired CSP outcomes.

104. Monitoring of the RPJM is being strengthened with the introduction of annual work plans, their link to an outcome-based budget, and the gradual introduction of a medium-term expenditure framework. ADB will provide TA to the Government to help establish the consultative processes for a results framework for the next medium-term plan. The Central Bureau of Statistics regularly publishes survey data that allow detailed tracking of MDG-related outcomes, as well as economic growth and job creation. Measures of corruption are regularly published by international NGOs. ADB, the World Bank, USAID, and GTZ are working on a measurement system to regularly evaluate the performance of local governments.

105. CSP monitoring and evaluation will follow the indicators included in the results framework and the road maps. Progress indicators have been selected in both so they can be realistically measured without posing an additional burden. The development of the CSP has been used to initiate discussions with the Government on results orientation as a management tool, in line with the Government's introduction of an output budgeting system. Continued work to further results orientation will be needed under the CSP. The Government and ADB will jointly evaluate midterm progress as well as achievements at the end of the CSP. The midterm and final evaluation of CSP outcomes will be shared with the other agencies and civil society.

Table 5: Country Strategy and Program Results Framework (2006–2009)

Government's Medium Term Development Agenda (RPJM)		Asian Development Bank Strategic Focus		Direction of Interventions
Strategic Goals	Key Constraints	CSP Outcomes	Tracking Indicators	
Pillar I: Pro-Poor, Sustainable Economic Growth				
<ul style="list-style-type: none"> Higher economic growth through greater investments, including enhanced infrastructure provision 	<ul style="list-style-type: none"> Low investments in infrastructure Low private sector participation in infrastructure development due to adverse investment climate Weak legal and regulatory environment Inadequate land acquisition mechanisms in place Lack of basic infrastructure in remote areas 	<p>A. Infrastructure and Infrastructure Services</p> <ul style="list-style-type: none"> Strengthened legal and regulatory framework for private sector participation in infrastructure development Accelerated private sector participation Long-term financing mechanisms for infrastructure financing under development Targeted provision of basic infrastructure and support services to communities 	<ul style="list-style-type: none"> At least 3 regulatory bodies made fully independent by 2009 At least 20% of private sector financing provided by domestic financial institutions by 2009 10 PPP infrastructure projects for which bidding completed by 2008 Annual Investments in infrastructure at least 7% of GDP by 2009 Private sector mobilization of 40%-50% of infrastructure investments by 2009 Number of communities receiving basic infrastructure support more than 2000 by 2009 	<p>Program Lending</p> <ul style="list-style-type: none"> Infrastructure sector reforms Financial sector reforms State-owned enterprise reforms <p>Investments</p> <ul style="list-style-type: none"> Non-recourse lending to SOEs Sovereign and non-recourse lending for PPPs Sovereign lending for transport and energy projects Infrastructure financing facility Capacity development in project preparation
<ul style="list-style-type: none"> Greater domestic resource mobilization to support growth 	<ul style="list-style-type: none"> Inefficient intermediation and allocation Limited range and financial instruments Weak enforcement of the legal and regulatory environment Weak risk management in financial institutions 	<p>B. Financial Sector Deepening</p> <ul style="list-style-type: none"> Long-term financing options strengthened Legal and regulatory environment strengthened and improved enforcement Long-term investment options increased More efficient financial sector intermediation Role of nonblank sector in financial implementation 	<ul style="list-style-type: none"> Increase in the size of the local bond market 30% by 2009 Enhanced capacity among regulators to strengthen the regulatory environment Number of institutional investors providing long-term financing increased by 20% in 2009 	<p>Program Lending</p> <ul style="list-style-type: none"> Financial Sector Policy Reforms <p>Project Lending</p> <ul style="list-style-type: none"> Non-sovereign loans to SOEs, municipal entities, financial intermediaries including microfinance institutions Issuance of local currency bonds

		increased		
Government's Medium Term Development Agenda (RPJM)		Asian Development Bank Strategic Focus		Direction of Interventions
Strategic Goals	Key Constraints	CSP Outcomes	Tracking Indicators	
		<ul style="list-style-type: none"> Capacity of financial sector to provide long-term financing enhanced 	<ul style="list-style-type: none"> Increased competition in rural and microfinance markets following consolidation of BPRs leading to a decrease of 2 percentage points in borrowing costs, by 2009 ADB successfully issued 3 local currency bonds by 2009 	
Pillar II: Social Development				
<ul style="list-style-type: none"> Greater fiscal and human capacity for sustainable service delivery 	<ul style="list-style-type: none"> Unequal financing of the regions Lack of capacity at the local level Fragile districts throughout the country 	A. Decentralization <ul style="list-style-type: none"> Financing of local government investments secured on a sustainable basis Improved capacity for fiscal accountability at the local levels Intergovernmental fiscal relations clarified Functional assignments at all levels of government established Central government financing of local government based on needs Clear local government fiscal accountability framework established Investments in social infrastructure in accelerated Strengthened regional government capacities 	<ul style="list-style-type: none"> Increase in regional development spending by 10% annually up to 2009 Improvement in quality of and consistency of local government financial reporting 	Program Lending <ul style="list-style-type: none"> Local Government Financing and Governance Reforms Investments <ul style="list-style-type: none"> Capacity Development

Government's Medium Term Development Agenda (RPJM)		Asian Development Bank Strategic Focus		Direction of Interventions
Strategic Goals	Key Constraints	CSP Outcomes	Tracking Indicators	
<ul style="list-style-type: none"> Quantity and quality of social service delivery improved 	<ul style="list-style-type: none"> Low financial and management technical capacities Local budgeting and planning not aligned Low health and education spending 	B. MDG Acceleration <ul style="list-style-type: none"> Pro-poor planning and budgeting at the local levels improved Public expenditures at local levels better aligned with local poverty reduction strategies Systems of administered prices and subsidies improved 	<ul style="list-style-type: none"> Health and education spending at least 3% of GDP by 2009 Improved reporting of district health accounts in at least 5 provinces by 2009 	Program Loans <ul style="list-style-type: none"> MDG Acceleration Investments <ul style="list-style-type: none"> Water Supply and Sanitation Integrated Settlements Neighborhood Upgrading II Rural infrastructure Community Water Supply and Health II Community and Local Government Support II
<ul style="list-style-type: none"> Natural resource management done on a more sustainable basis, with an economic return for the poor Incidence of pollution reduced 	<ul style="list-style-type: none"> Inadequate natural resources management capacity at national and local levels Overlapping mandates and functions of Government agencies Low awareness among Government, the public, and resource users on sustainable resource management Increased pressure on natural resources for livelihoods Lack of integrated water management in a basin context Weak pollution control 	C. Environment and Natural Resources Management <ul style="list-style-type: none"> Improved management of water resources Improved coastal and marine resources management Creation of livelihoods/ economic opportunities Well-functioning community-based management Adherence to principles of integrated coastal resources management Well-managed coastal and marine protected areas Implementation strategy on air quality improvement strengthened 	<ul style="list-style-type: none"> Extent of irrigation schemes Better water supply Reduced flood and drought risks 6,000 ha of coral reef rehabilitated by 2009 700 ha of marine protected areas managed in a sustainable manner by 2009 30% increase in aquaculture production in 6 districts by 2009 Increase of natural gas use in public transport and industry sector at least 5% in selected cities in 2009. 	Investments <ul style="list-style-type: none"> Water Resources Management Flood Protection Coastal Resources Management Investment and Program Loans <ul style="list-style-type: none"> Urban Air Quality

Government's Medium Term Development Agenda (RPJM)		Asian Development Bank Strategic Focus		Direction of Interventions
Strategic Goals	Key Constraints	CSP Outcomes	Tracking Indicators	
	<ul style="list-style-type: none"> Inadequate public-private investment for air quality improvement 	<ul style="list-style-type: none"> Investment in air quality improvement initiated Air quality management capacity of participating city governments built Compliance with national ambient air quality standards at least 340 days in a year latest by 2015 	<ul style="list-style-type: none"> Unleaded gasoline with sulfur content of 500 ppm and diesel fuel with sulfur content of 500 ppm available nationwide by 2007 Reduction of air emissions from motor vehicles by 50% in 2020 vs. the level of emissions in 2007 in participating cities Reduction of air pollution from industrial activities by 50% in 2020 vs. that in 2007 	
Key Thematic Area: Governance and Anticorruption				
<ul style="list-style-type: none"> Accelerated economic growth through improved investments and better public sector management 	<ul style="list-style-type: none"> Unskilled workforce in the public sector performing poorly; lack of accountability and performance standards and measurements Corruption systemic in the public sector 	<ul style="list-style-type: none"> Improved and measured performance in key sectors Strengthened anticorruption mechanisms and institutions Improved interaction between levels of government Improved public sector performance Reduced corruption 	<ul style="list-style-type: none"> Relationship of DAK to DAU transfer increased to 30/70 by 2009 Strengthened prevention capacity of KPK All Government accounts transferred to a Treasury single account An improvement in Indonesia's ranking in Transparency International's corruption perception index of at least 15 places 	<p>Program Lending</p> <ul style="list-style-type: none"> Local Government Financing and Governance Reforms State Audit Reform Sector Program Retrenchment and Early Retirement Schemes as part of civil service reform Development Policy Support Program <p>Others</p> <ul style="list-style-type: none"> Strengthening the Prevention Capacity of KPK Continued procurement reform

COUNTRY AND PORTFOLIO INDICATORS, AND ASSISTANCE PIPELINE

Table A1.1: Progress Toward the Millennium Development Goals and Targets

Goals and Targets	Country Status
Goal 1: Eradicate Extreme Poverty and Hunger	
Target 1: Halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day.	With the poverty incidence still above 17%, Indonesia is still far from reaching the 2015 target of 7.5%.
Target 2: Halve, between 1990 and 2015, the proportion of people who suffer from hunger.	Indonesia remains off-track. The malnutrition rate for children under 5 is currently 28%, compared with the target of 18.3%.
Goal 2: Achieve Universal Primary Education	
Target 3: Ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling.	May be achieved.
Goal 3: Promote Gender Equality and Empower Women	
Target 4: Eliminate gender disparity in primary and secondary education, preferably by 2005, and in all levels of education no later than 2015.	Parity has been reached at the elementary and junior secondary levels, although improvements are required at the senior secondary and tertiary levels. The main issue is in the workplace where women face higher levels of unemployment and lower wages than men, even when their education and experience are the same.
Goal 4: Reduce Child Mortality	
Target 5: Reduce by two thirds, between 1990 and 2015, the under-5 mortality rate.	Indonesia is on track.
Goal 5: Improve Maternal Health	
Target 6: Reduce by three quarters, between 1990 and 2015, the maternal mortality ratio.	Despite apparent recent improvements in the maternal mortality ratio, measurement is still imprecise and it is believed the true incidence is being underestimated. Concerted efforts will be required for Indonesia to achieve this goal.
Goal 6: Combat HIV/AIDS, Malaria, and Other Diseases	
Target 7: Have halted by 2015, and begun to reverse, the spread of HIV/AIDS.	In recent years the number of HIV/AIDS cases in Indonesia has grown exponentially among groups practicing high-risk behavior. Prevalence in Indonesia has now passed the concentrated epidemic level of 0.1% and the country is now on the edge of a general epidemic.
Target 8: Have halted by 2015, and begun to reverse, the incidence of malaria and other major diseases.	Malaria is endemic to many areas outside the cities and is being reported in several places where it was earlier unknown. Drug resistance is also being reported. Tuberculosis is the biggest killer of adults after cardiovascular diseases. The number of deaths from avian influenza has reached 48, the highest of any country. The Government has no clear strategy, capacity, or resources to fight the disease.

Goal 7: Ensure Environmental Sustainability	
Target 9: Integrate the principles of sustainable development into country policies and programs and reverse the loss of environmental resources.	Many indicators show Indonesia is suffering significant environmental deterioration. Responsibility for environmental management lies with local governments, which experience serious constraints and have weak capacities.
Target 10: Halve, by 2015, the proportion of people without sustainable access to safe drinking water.	Data show improving trends for both sanitation and water supply. However, as in the case of health and education, concerted efforts by regional governments will be necessary to achieve the targets by 2015.
Target 11: Halve, by 2015, the proportion of people without sustainable access to basic sanitation.	
Target 12: By 2020, achieve a significant improvement in the lives of at least 100 million slum dwellers.	

Sources: BPS. 2005. *Socio Economic Survey*. Jakarta. BPS and Ministry of Health. 2004. *Demographic Health Survey*. Jakarta

Table A1.2: Country Economic Indicators

Item	Fiscal Year						
	1999	2000	2001	2002	2003	2004	2005
A. Income and Growth							
1. GDP per Capita (\$, current)	697.6	801.9	787.6	965.5	1,116.2	1,190.6	1,343.3
2. GDP Growth (% , in constant prices)	0.8	4.9	3.8	4.3	5.0	4.9	5.6
a. Agriculture	2.2	1.9	4.1	2.8	4.8	2.1	2.5
b. Industry	2.0	5.9	2.7	4.4	3.8	3.7	4.4
c. Services	(1.0)	5.2	5.0	4.7	6.5	7.3	8.0
B. Saving and Investment							
	(% of GDP)						
1. Gross Domestic Investment	11.4	21.3	23.5	20.4	17.3	21.3	21.3
2. Gross National Saving	19.5	31.8	31.5	26.4	24.9	24.2	26.3
C. Money and Inflation							
	(annual % change)						
1. Consumer Price Index ^a	20.4	3.8	11.5	11.9	9.8	3.1	10.5
2. Total Liquidity (M2)	11.9	15.6	13.0	4.7	8.1	8.1	16.4
D. Government Finance							
	(% of GDP)						
1. Revenue and Grants	18.2	14.8	17.9	16.1	16.4	15.1	15.0
2. Expenditure and Onlending	21.1	15.9	20.3	18.2	18.1	16.2	15.5
3. Overall Fiscal Surplus (deficit)	(2.8)	(1.2)	(2.4)	(2.1)	(1.7)	(1.1)	(0.5)
E. Balance of Payments							
1. Merchandise Trade Balance (% of GDP)	14.7	15.2	14.1	12.0	10.5	8.5	8.1
2. Current Account Balance (% of GDP)	4.1	4.8	4.2	3.8	3.4	1.2	1.1
3. Merchandise Export (\$) Growth (annual % change)	1.72	27.6	(12.3)	3.1	8.4	12.6	20.1
4. Merchandise Import (\$) Growth (annual % change)	(4.2)	31.9	(14.1)	2.8	10.9	28.0	26.2
F. External Payments Indicators							
1. Gross Foreign Assets Outstanding, including gold, \$ million ^b	27.1	29.4	28.0	32.0	36.3	36.3	34.7
2. Import cover (months of imports that can be paid for out of foreign assets)	6.0	5.3	5.7	6.3	6.8	5.9	4.9
3. External Debt Service (% of exports of goods and services)	65.8	41.3	36.0	32.1	29.8	31.2	38.6
4. Total External Debt (% of GDP)	105.8	85.9	81.1	64.4	56.8	53.9	47.4
G. Memorandum Items							
1. GDP (current prices, Rp trillion)	1,099.8	1,389.8	1,684.3	1,897.8	2,045.8	2,273.1	2,729.7
2. Exchange Rate (Rp/\$, average)	7,855	8,422	1,0261	9,314	8,577	8,939	9750
3. Population (million) ^c	200.7	205.8	208.4	211.1	213.7	216.4	221.3

() = negative, GDP = gross domestic product.

^a 2000 base year.

^b Since January 1998, the official foreign exchange reserve position has been replaced by gross foreign assets. 1995–1999 data are from United Nations. 2001. *Common Country Assessment for Indonesia*. Jakarta

^c Using 1.35% as annual average of growth for 1990–2000, as a population census is held every 10 years.

Sources: Central Bureau of Statistics, Ministry of Finance, and Bank of Indonesia.

Table A1.3: Country Poverty and Social Indicators

Item	Period		
	1985	1990	Latest Year
A. Population Indicators			
1. Total Population (million) ^a	164.6	179.4	221.3 (2005)
2. Annual Population Growth Rate (% change) ^a	2.2	2.0	1.25
B. Social Indicators			
1. Total Fertility Rate (births/woman) ^a	3.1 (1987)	3.0 (1991)	2.8 (1997)
2. Maternal Mortality Ratio (per 100,000 live births) ^a	360 (1984–1988)	390 (1990–1994)	307 (2002–2003)
3. Infant Mortality Rate (below 1 year/1,000 live births) ^a	67.4 (1987)	67.8	35 (2003)
4. Life Expectancy at Birth (years) ^b			
a. Female	61.5	61.5	68.2 (2002)
b. Male	57.9	57.9	64.3 (2002)
5. Adult Literacy (%) ^b	69 (1980)	84	87.3 (2003)
a. Female	66 (1980)	79	82.9 (2003)
b. Male	83 (1980)	90	91.8 (2003)
6. Primary School Gross Enrollment (%) ^c			105.8 (2003)
a. Female	114	110	105.6 (2003)
b. Male	120	115	106.0 (2003)
7. Junior Secondary School Gross Enrollment (%) ^c		61.1 (1993)	81.1 (2003)
a. Female	—	60.0 (1993)	82.4 (2003)
b. Male	—	62.2 (1993)	79.9 (2003)
8. Child Malnutrition (% below age 5) ^d	51 (1986)	44 (1989)	28.2 (2003)
9. Population with Access to Safe Water (%) ^c	—	60.3 (1993)	75.0 (2003)
10. Population with Access to Sanitation (%) ^c	—	36.9 (1993)	58.8 (2003)
11. Public Education Expenditure (% of GDP) ^g	1.5	1.0	0.8 (2004)
12. Human Development Index ^b	0.578	0.618	0.692 (2002)
Rank	81	89	110 (2003)
13. Gender-Related Development Index ^b	—	—	0.685 (2002)
Rank	—	—	90 (2003)
C. Poverty Indicators			
1. Poverty Incidence (national poverty line) ^f	21.6	15.1	17.8 (2006)
2. Poverty Gap ^f	—	2.68 (1990)	2.89 (2004)
3. Poverty Severity Index ^f	—	0.74 (1990)	0.78 (2004)
4. Inequality (Gini Ratio) ^f	.33 (1984)	0.32 (1990)	0.35 (2004)
5. Human Poverty Index Value ^e	—	27.6	17.8 (2002)
6. Human Poverty Index Rank ^e	—	—	33 (2002)

— = not available, GDP = gross domestic product.

^a Central Bureau of Statistics (BPS), Badan Perencanaan Pembangunan Nasional (BAPPENAS), United Nations Populations Fund (UNFPA), Indonesia Population Projection, 2000–2025, Jakarta 2005. Data is based on the 2000 population census.

^b UNDP, *Human Development Report 2005*. Available: <http://hdr.undp.org>

^c BPS National Socioeconomic Survey (SUSENAS), data from various years.

^d BPS Social Welfare statistics underweight for age (% under age 5) includes both moderate and severely malnourished; safe water means piped, pumped, or protected well or spring.

^e http://hdr.undp.org/statistics/data/country_fact_sheets/cty_fs_IDN.html for latest and http://globalis.gvu.unu.edu/indicator_detail.cfm?Country=ID&IndicatorID=15 for human development index in 1985 and 1990.

^f BPS

^g Ministry of National Education.

Table A1.4: Country Environment Indicators

Indicator	Earlier Year	Latest Year
A. Energy Efficiency of Emissions		
1. GDP/Unit of Energy Use (PPP\$/kgoe)	4.2 (2000) ^a	4.1 (2002) ^a
2. Traditional Fuel Use (% of total energy use)	24.8 (2001) ^a	17.6 (2002) ^a
3. Carbon Dioxide Emissions		
a. Million tons	251.5 (2001) ^a	275.2 (2002) ^a
b. Tons per capita	1.18 (2001) ^a	1.44 (2002) ^a
B. Water Pollution: Water and Sanitation		
1. % Urban Population with Access to Safe Water	88.2 (2000) ^c	86.7 (2004) ^c
2. % Rural Population with Access to Safe Water	64.7 (2000) ^c	68.7 (2004) ^c
3. % Urban Population with Access to Sanitation	64.9 (2000) ^c	70.2 (2004) ^c
C. Land Use and Deforestation		
1. Forest Area (thousand square km)	978.5 (2000) ^a	884.9 (2005) ^a
2. Forest Area (% of the total area)	54 (2000) ^a	48.8 (2005) ^a
3. Average Annual Deforestation		
a. Square kilometers	13,124 (2000) ^a	0 (2002) ^a
b. % change	1.2 (1999) ^a	0 (2000) ^a
4. Rural Population Density (people/km ² of arable land)	575 (2002) ^a	556.8 (2003) ^a
5. Arable Land (% of total land)	11.3 (2002) ^a	11.06 (2003) ^a
6. Permanent Cropland (% of total land)	7.3 (2002) ^a	7.4 (2003) ^a
D. Biodiversity and Protected Areas		
1. Nationally Protected Area		
a. Million square km	35.74 (2001) ^a	37.2 (2005) ^a
b. % of total land	19.7 (2001) ^a	20.6 (2005) ^a
2. Mammals (number of threatened species)	147 (2001) ^a	147 (2005) ^a
3. Birds (number of threatened species)	114 (2001) ^a	114 (2005) ^a
4. Higher Plants (number of threatened species)	264 (2002) ^a	384 (2005) ^a
5. Reptiles (number of threatened species)	31 (1999) ^a	28 (2003) ^a
6. Amphibians (number of threatened species)	22 (1997) ^a	0 (2003) ^a
7. Fish (number of threatened species)		68 (2003) ^a
E. Urban Areas		
1. Urban Population		
a. Million	97.7 (2003) ^a	101.61 (2004) ^a
b. % of total population	42 (2001) ^b	48.3 (2005) ^b
2. Per Capita Water Use (liters/day)	-	-
3. Wastewater Treated (%)	-	3 (2006) ^a
4. Solid Waste Generated Per Capita (kg/day)	0.66 (1998) ^a	0.66 (1998) ^a

— = not available, kg = kilogram, kgoe = kilograms of oil equivalent, km² = square kilometer, PPP = purchasing power parity,

Sources:

^a World Development Indicators online, <http://devdata.worldbank.org/wdi2005/cover.htm>.

^b World Bank. 2005. *The Little Green Data Book*. 2005.

^c United Nations Development Programme. 2005. *Millennium Development Goals Report, 2005*.

^d 2004 National Economic and Social Survey (SUSENAS).

Table A1.5: Development Coordination Matrix

Sectors	ADB Strategy	Other development partners' strategies and / or main activities	
Energy	Support will focus on energy development, renewable energy, local grids and energy efficiency initiatives, with a view to substantially reducing power transmission and distribution losses.	Japan	Supporting power generation from conventional and renewable energy sources.
		World Bank	Improving the legal and policy framework to help attract private sector investors. Restructuring electricity and gas entities. Improving the tariff structure for the gas sector.
Transport and Communications	Support will be designed to enhance the provision of road infrastructure to promote economic growth.	Australia	Undertaking road improvement in eastern Indonesia.
		Germany	Focusing on achieving greater mobility for lower-income population groups through passenger shipping (with container transport) and local passenger transport (rail) in the Jakarta metropolitan area.
		Japan	Building transport infrastructure in Java and Sulawesi.
		World Bank	Building national and local transport and communication infrastructure.
Finance	Financial sector reform support will include better supervision of non-bank financial markets, capital market development, development and enhancement of mortgages and microfinance, and innovative financing for infrastructure.	Australia	Supporting audit, treasury, and tax reforms.
		World Bank	Strengthening and diversifying the financial sector through financial safety nets, improving SME access to microfinance. Strengthening the banking sector.
Health, Nutrition, and Social Protection	Support will focus on improving local services delivery.	Australia	Increasing the accessibility and quality of health services, including HIV/AIDS prevention, women's health, family welfare, maternal health (eastern Indonesia), Bali health assistance, capacity development for decentralized health services.
		Canada	Improving the quality of decentralized health services through (i) improving local governments' capacity to link policy, planning, and budgeting, and to develop strategic and fiscal plans; (ii) strengthening central government's capacity to implement policy, guidelines, and systems that will ensure effective decentralization; and (iii) improving local government's capacity to plan and implement consultation strategies and use consultation outputs.
		European Union	Strengthening governance in health administration.
		Germany	Formulating approaches to the health policy and their implementation in the decentralization and deregulation process. Support will also be given to provinces, districts and local authorities in autonomous financing and implementation of the national health policy as demand-driven services to the population.
		Netherlands	Supporting early childhood development and HIV/AIDS education.

Sectors	ADB Strategy	Other development partners' strategies and / or main activities	
		UNICEF	<ul style="list-style-type: none"> Promoting effective home-based care for young children and women, and the prevention and early treatment of illness. Social and legal protection against all forms of discrimination, violence, exploitation, abuse and neglect of children in both urban and rural areas, paying particular attention to girls. Areas addressed include commercial sexual exploitation, the sale and trafficking of children, child abuse, children who live and work on the street, birth registration and juvenile justice. Strengthening national and provincial child protection bodies and supporting legal reforms and better enforcement of existing laws. An emergency support program to address the priority needs of children and women caught up in emergencies. Special attention will be given to the immediate needs of children and women, including fortified food, water and sanitation facilities, medical and educational supplies, and interventions to deal with psycho-social trauma.
		United States	Rural water supply and sanitation to improve maternal and child health and hygiene.
		WHO	<ul style="list-style-type: none"> Strengthening communications, monitoring, prevention of avian influenza. Provision of basic health services for natural disaster victims and internally displaced persons (IDP). Development of health workforce at the regional level. Reduction of polio and tuberculosis.
		World Bank	Improving the quality and coverage of basic health services. Building capacity in maternal health, child health, and nutrition.
Education	Support will focus on improving local delivery of services.	Australia	Increasing accessibility and quality of education, focusing on basic education and Islamic schools (including teachers)
		Canada	Improving the quality of decentralized social services,
		European Union	Supporting for basic education (Nusa Tenggara provinces) and strengthening governance in education.
		Netherlands	Supporting basic education, vocational and technical education, teacher training.
		Japan	Support for ICT education (Jogjakarta), basic education, engineering education (Sulawesi), and polytechnic education.
		UNICEF	Education programs will focus on structural problems that block access, contribute to high drop-out rates, and negatively affect the quality of the educational system.
		United States	Improving the quality and relevance of basic education in Indonesia, in public and private, religious and secular schools by working with communities and local governments to improve school management and train teachers.
		World Bank	Supporting basic, vocational and technical education.
Water Supply Sanitation	Support will focus on improving local delivery of services.	Australia	Improving the planning and administration capacities, and services for water supply and sanitation services.

Sectors	ADB Strategy	Other development partners' strategies and / or main activities	
and Waste Management		Netherlands	Supporting water resources management and irrigation; capacity building for water sector management.
		Japan	Improving water supply in urban areas in Solo, Makassar, Bandar Lampung, South Bali and Sumatra. Developing sewerage systems in Medan and Denpasar. Supporting industrial waste management.
		World Bank	Improving the quality and coverage of water supply and sanitation for low-income communities.
Agriculture and Natural Resources.	Support will focus on water resources management, primarily through project financing. Support will be provided for integrated water resources management, including investments in infrastructure and management of multipurpose facilities developed in a basin context, and flood management.	Australia	Supporting the management of coral reefs.
		Canada	Protecting and creating sustainable livelihoods through equitable access to, and sustainable management of, natural resources.
		European Union	Improving water resources management (Nusa Tenggara provinces), irrigated agriculture (Java and Sulawesi)
		Netherlands	Supporting water resources and irrigation reform, including flood management, and river basin management.
		United States	Supporting local water resources management.
		UNDP	Supporting the enhancement of key environmental governance institutions, and promoting the revision of policies and regulations at various levels for sustainable natural resource management.
		World Bank	Supporting local water resources management, agricultural research, extension and irrigation, and management of coral reef ecosystems.
Law, Economic Management, and Public Policy	ADB will support the Government's decentralization agenda by remaining focused on policy reforms and capacity development.	Australia	Expanding assistance for strengthening governance through support for economic reform, legal and judicial reform, the promotion and protection of human rights and on-going support for counter-terrorism initiatives
		Canada	Supporting reform of the financial management system fiscal framework, and decentralized administration.
		United Kingdom	Strengthening development effectiveness through harmonization. This priority focuses on decentralization through programs relating to decentralized governance, civil society mobilization, and poverty reduction. Supporting the partnership for governance reform to promote and support reform initiatives.
		European Union	Supporting judiciary reforms and anticorruption measures, empowerment of local parliaments and civil society, competition policy, and corporate governance.
		Germany	Providing advisory services on decentralization and good governance to create the conditions for stable political, economic and social development aimed at reducing poverty.
		Netherlands	Supporting strengthening private sector participation in urban infrastructure; local government capacity building for decentralization; legal and judicial reform.
		UNDP	Promoting good governance in all its aspects, including ensuring the rule of law, improving the efficiency and accountability of the public sector, and

Sectors	ADB Strategy	Other development partners' strategies and / or main activities	
			eliminating corrupt practices is an essential element to the achievement of sustainable development. Improving the management of public resources and enhancing public sector accountability and transparency and developing greater public awareness about the need for and requirements of good governance.
		United States	Strengthening effective democratic and decentralized governance.
		World Bank	<ul style="list-style-type: none"> • Making development planning more responsive to constituents. • Improving public financial management. • Strengthening the accountability of local governments under a more coherent decentralization framework • Enhancing the public credibility, impartiality and accessibility of the justice sector.
Industry and Trade		Australia	Strengthening SMEs in eastern Indonesia
		Canada	Promoting private sector development at the SME level through (i) creating sustainable SME growth and equitable creation of more and better jobs; and (ii) strengthening public and private institutions to support competitive local and national markets for SMEs that function well
		European Union	SMEs and business development services support in Central Java.
		Germany	Strengthening SME competitiveness and financing instruments.
		Japan	Supporting investment promotion policy, competition policy and administration, industrial standardization and property rights; human resources development for SMEs related to manufacturing industries. Capacity building to implement WTO policies.
Humanitarian and Emergency Assistance	<p>ADB will provide support for physical and social infrastructure and livelihoods for Aceh and Nias.</p> <p>It will help to identify risks, building disaster management and hazard management capacity at country level.</p>	Australia	<ul style="list-style-type: none"> • Reconstruction of tsunami and other disaster-affected areas through the Australia Indonesia Partnership for Reconstruction and Development. • Aceh rehabilitation program focusing on health, education, governance and restoration of public infrastructure • Developing systems for managing and responding to the impact of natural disasters.
		Canada	<ul style="list-style-type: none"> • Improving the planning and delivery of reconstruction activities and public services. • Creating and restoring sustainable livelihoods. • Restoration and sustainable use of natural resources.
		United Kingdom	Supporting livelihood and community infrastructure through multidonor fund and multilateral agencies.
		European Union	Supporting health care, water sanitation, shelter and livelihood recovery in Aceh.
		Germany	Supporting the reconstruction of village infrastructure including health care and sanitation facilities.

Sectors	ADB Strategy	Other development partners' strategies and / or main activities	
		Netherlands	Supporting water resources and water supply and transport infrastructure in Aceh.
		Japan	Supporting transport and social infrastructure in Aceh
		UNDP	<ul style="list-style-type: none"> • Improving Indonesia's capacity to effectively recover from violent conflicts and prevent their re-emergence. • Supporting disaster management and mitigation.
		United States	Supporting transport infrastructure and strengthening local governance in Aceh.
		World Bank	Multisector support for reconstruction and rehabilitation of Aceh and Nias through the multidonor fund.

Table A1.6: Portfolio Indicators—Portfolio Amounts and Ratings
(public sector loans, as of 31 July 2006)

Sector	Net Loan Amount		Rating														
			Total		Highly Satisfactory		Satisfactory		Partly Satisfactory		Unsatisfactory		Potential Problem		At Risk		
	\$ million	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	%	No.	(%)	
Agriculture and Natural Resources	531.5	16.6	12	30.8	0	0	12	100.0	0	0	0	0	0	0	0	0	0
Education	291.2	9.1	2	5.1	0	0	2	100.0	0	0	0	0	0	0	0	0	0
Energy	485.2	15.1	3	7.7	0	0	3	100.0	0	0	0	0	0	0	0	0	0
Finance	-	-	-	-	0	0	0	0	0	0	0	0	0	0	0	0	0
Health, Nutrition, and Social Protection	107.6	3.0	2	5.0	0	0	3	100.0	0	0	0	0	0	0	0	0	0
Industry and Trade	85.0	2.6	1	2.6	0	0	1	100.0	0	0	0	0	0	0	0	0	0
Law and Public Sector Management	885.6	27.6	7	17.9	1	14.3	6	85.7	0	0	0	0	0	0	0	0	0
Multisector	417.5	13.0	9	23.1	0	0	9	100.0	0	0	0	0	0	0	0	0	0
Transport and Communications	341.0	10.6	2	5.1	0	0	2	100.0	0	0	0	0	0	0	0	0	0
Water Supply, Sanitation, and Waste Management	65.0	2.4	1.0	2.7	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	3,209.6	100.0	39	100.0	1	2.6	38	97.4	0	0	0	0	0	0	0	0	0

No. = number.

Source: Asian Development Bank estimates.

Table A1.7: Portfolio Indicators—Disbursements and Net Transfers of Resources
(public sector loans, as of 31 December 2005)

Disbursements and Transfers	OCR	ADF	Total
Disbursements ^a			
Total Funds Available for Withdrawal (\$ million)	3,032.5	575.4	3,607.9
Disbursed Amount (\$ million, cumulative)	2,163.2	160.3	2,323.5
Percentage Disbursed (disbursed amount/total available)	71.3	27.8	64.4
Disbursements (\$ million, latest year)	947.3	67.7	1,015.0
Disbursement Ratio (%) ^b	50.0	13.0	42.1
Net Transfer of Resources (\$ million)			
2001	(47.9)	4.4	(43.5)
2002	121.6	1.0	122.6
2003	(431.5)	30.1	(401.4)
2004	(282.1)	28.9	(253.2)
2005	107.0	37.6	144.6

() = negative, ADF = Asian Development Fund, OCR = ordinary capital resources.

^a Includes ongoing loans and loans with disbursements during 2005.

^b Ratio of disbursements during the year over the undisbursed net loan balance at the beginning of the year less cancellations during the year. Effective loans during the year have also been added to the beginning balance of undisbursed loans.

Source: Asian Development Bank estimates.

Table A1.8: Portfolio Indicators—Evaluation Rating by Sector
(1996–2005)

Sector	Highly Successful		Successful		Partly Successful		Unsuccessful		No. Rating	
	No.	%	No.	%	No.	%	No.	%	No.	%
Agriculture and Natural Resources	0	0	5	55.6	2	22.2	2	22.2	0	0
Energy	0	0	0		0		0		0	0
Finance	0	0	0	0.0	1	100.0	0	0.0	0	0
Industry and Nonfuel Minerals	0	0	0		0		0		0	0
Multisector	0	0	2	66.7	1	33.3	0	0.0	0	0
Others	0	0	0		0		0		0	0
Social Infrastructure	1	9.1	7	63.6	3	27.3	0	0.0	0	0
Transport and Communications	3	37.5	5	62.5	0	0.0	0	0.0	0	0
Total	4	12.5	19	59.4	7	21.9	2	6.3	0	0

No. = number.

Source: Operations Evaluation Department/Post Evaluation Information System.

Table A1.9: Portfolio Implementation Status
(public sector loans, as of 31 December 2005)

Sector	Loan No.	Seq No.	Title	Net Loan Amount		Approval Date (dd/mm/yy)	Effective Date (dd/mm/yy)	Closing Date (dd/mm/yy)		Progress (% complete)
				OCR (\$ million)	ADF			Original	Revised	
AG	1469		Integrated Pest Management for Smallholder Estate Crops Project	38.2	0.0	26-Sep-96	07-Jan-97	30-Sep-04	31-Dec-05	99
AG	1479		South Java Flood Control Sector Project	88.2		07-Nov-96	27-Jan-97	30-Sep-03	30-Sep-05	97
AG	1526		Participatory Development of Agriculture Technology	56.2		01-Jul-97	27-Aug-97	30-Sep-04	31-Dec-05	90
AG	1570		Coastal Community Development and Fisheries Resource Management Project	18.5	17.0	04-Nov-97	21-Apr-98	31-Dec-03	31-Dec-05	98
AG	1571		Coastal Community Development and Fisheries Resource Management Project		14.0	04-Nov-97	21-Apr-98	31-Dec-03	31-Dec-05	98
AG	1579		Northern Sumatra Irrigated Agriculture Sector Project	68.2		13-Nov-97	23-Feb-98	31-Oct-04	31-Dec-05	83
AG	1605		Central Sulawesi Integrated Area Development and Conservation Project	23.1		27-Jan-98	15-May-98	30-Sep-05	31-Dec-05	89
AG	1770		Marine and Coastal Resources Management Project		55.8	26-Oct-00	27-Sep-01	30-Jun-07		53
AG	1909		Poor Farmer Income Improvement Through Innovation Project		60.4	15-Aug-02	17-Jul-03	30-Jun-08		29
AG	1962		Coral Reef Rehabilitation and Management II		35.9	06-Dec-02	07-Nov-03	31-Dec-09		21
AG	2064		Participatory Irrigation Sector Project		19.0	19-Dec-03	02-Jun-05	30-Jun-11		2
AG	2065		Participatory Irrigation Sector Project	54.0		19-Dec-03	02-Jun-05	30-Jun-11		2
ED	1792		Technological and Professional Skills Development Sector Project	180.0		29-Nov-00	04-Jun-01	30-Jun-07		82
ED	1863		Decentralized Basic Education		111.2	29-Nov-01	20-May-02	31-Dec-08		59
EN	1271		Power XXIII Project	184.2		25-Nov-93	26-May-94	31-Dec-00	30-Sep-06	71

ADF = Asian Development Fund, AG = agriculture and natural resources, ED = education, EN = energy, MS = multisector, No. = number; OCR = ordinary capital resources.

Source: Asian Development Bank

Sector	Loan No.	Seq No.	Title	Net Loan Amount		Approval Date (dd/mm/yy)	Effective Date (dd/mm/yy)	Closing Date (dd/mm/yy)		Progress (% complete)
				OCR (\$ million)	ADF			Original	Revised	
EN	1982		Renewable Energy Development Sector Project	161.0		19-Dec-02	27-Oct-04	30-Sep-08		13
EN	1983		Power Transmission Improvement Sector Project	140.0		19-Dec-02	27-Oct-04	30-Sep-08		13
HL	1810		Decentralized Health Services Project		72.7	14-Dec-00	25-Jun-01	30-Sep-06		75
HL	2074		Second Decentralized Health Services Project (DHS2)	64.8		19-Dec-03	29-Mar-05	31-Dec-10		0
HL	2075		Second Decentralized Health Services Project (DHS2)		35.0	19-Dec-03	29-Mar-05	31-Dec-10		0
IN	1978		Small and Medium Enterprises Export Development Project	85.0		17-Dec-02	18-May-04	19-May-09		Dfi/credit
LW	1678		Community and Local Government Support Sector Development Program (CLGSSDP)	86.4		25-Mar-99	25-Mar-99	30-Sep-03	31-Mar-05	100
LW	1964		Sustainable Capacity Building for Decentralization		46.0	10-Dec-02	05-Sep-03	30-Jun-09		15
LW	2126		State Audit Reform Sector Development Program	200.0		13-Dec-04	17-Dec-04	31-Dec-07		Program
LW	2127		State Audit Reform Sector Development Program		23.9	13-Dec-04	17-Dec-04	30-Jun-10		10
LW	2192		Local Government Finance and Governance Reform Program	300.0		03-Nov-05	29-Dec-05	30-Jun-07		Program
LW	2193		Local Government Finance and Governance Reform Sector Development Project		29.6	03-Nov-05	29-Dec-05	30-Jun-09		0
LW	2228		Development Policy Support Program	200.0		21-Dec-05	23-Dec-05	31-Dec-06		Program
MS	1583	1	Rural Income Generation	20.1		25-Nov-97	18-Jun-98	30-Sep-05	31-Dec-06	88
MS	1583	2	Rural Income Generation	32.7		25-Nov-97	18-Jun-98	30-Sep-05	31-Dec-06	88
MS	1587		Metropolitan Medan Urban Development Project	82.8		08-Dec-97	30-Mar-98	30-Sep-03	31-Dec-05	80

ADF = Asian Development Fund; EN = energy; FI = finance; HL = health, nutrition, and social protection; HS = highly satisfactory; IN = industry and trade; IP = implementation progress; LW = law and public sector management; MS = multisector; No. = number; OCR = ordinary capital resources.

Source: Asian Development Bank

Sector	Loan No.	Seq No.	Title	Net Loan Amount		Approval	Effective	Closing Date		Progress (% complete)
				OCR (\$ million)	ADF	Date (dd/mm/yy)	Date (dd/mm/yy)	Original (dd/mm/yy)	Revised (dd/mm/yy)	
MS	1765		Community Empowerment for Rural Development		42.7	19-Oct-00	12-Mar-01	30-Jun-07		55
MS	1765		Community Empowerment for Rural Development Project	38.0		19-Oct-00	12-Mar-01	30-Jun-07		55
MS	2072		Neighborhood Upgrading and Shelter Sector Project	68.6		19-Dec-03	31-Mar-05	31-Dec-09		0
MS	2073		Neighborhood Upgrading and Shelter Sector Project		19.9	19-Dec-03	31-Mar-05	31-Dec-09		0
MS	2163		Community Water Services and Health Project	34.1		07-Apr-05	12-Apr-06	31-Dec-11		0
MS	2164		Community Water Services and Health Project		28.5	07-Apr-05	12-Apr-06	31-Dec-11		0
MS	2221		Rural Infrastructure Support Project		50.1	19-Dec-05	20-Jun-06	31-Mar-09		0
TC	1798		Road Rehabilitation (Sector) Project	190.0		11-Dec-00	28-Sep-01	31-Mar-05	28-Feb-07	60
TC	2184		Road Rehabilitation II	151.0		29-Sep-05		31-Dec-10		60
Total				2,565.2	644.3					

ADF = Asian Development Fund, MS = multisector, No. = number, OCR = ordinary capital resources, PS = partly satisfactory, S = satisfactory, Seg = segment (pertaining to loans with more than one withdrawal authority), TC = transport and communications.

Source: Asian Development Bank

Sector	Loan No.	Seq No.	Title	Cumulative Contracts/ Commitments (\$ million)	Cumulative Disbursements (\$ million)	Rating		Potential Problem ^a	At Risk ^b
						IP	DO		
AG	1469		Integrated Pest Management for Smallholder Estate Crops Project	25.0	29.0	S	S	No	No
AG	1479		South Java Flood Control Sector Project	73.8	84.4	S	S	No	No
AG	1526		Participatory Development of Agriculture Technology	39.5	46.7	S	S	No	No
AG	1570		Coastal Community Development and Fisheries Resource Management Project	14.0	15.5	S	S	No	No
AG	1571		Coastal Community Development and Fisheries Resource Management Project	12.7	12.5	S	S	No	No
AG	1579		Northern Sumatra Irrigated Agriculture Sector Project	57.0	56.3	S	S	No	No
AG	1605		Central Sulawesi Integrated Area Development and Conservation Project	18.5	20.2	S	S	No	No
AG	1770		Marine and Coastal Resources Management Project	29.0	24.4	S	S	No	No
AG	1909		Poor Farmer Income Improvement Through Innovation Project	13.4	10.5	S	S	No	No
AG	1962		Coral Reef Rehabilitation and Management II	7.4	4.9	S	S	No	No
AG	2064		Participatory Irrigation Sector Project	0.0	0.0	S	S	No	No
AG	2065		Participatory Irrigation Sector Project	0.0	0.3	S	S	No	No
ED	1792		Technological and Professional Skills Development Sector Project	127.2	107.6	S	S	No	No
ED	1863		Decentralized Basic Education	44.9	40.0	S	S	No	No
EN	1271		Power XXIII Project	178.4	158.8	S	S	No	No
EN	1982		Renewable Energy Development Sector Project	28.2	7.6	S	S	No	No

ADF = Asian Development Fund, AG = agriculture and natural resources, ED = education, OCR = ordinary capital resources, OCR = ordinary capital resources.

^a "Yes" for loans with four or more risk factors associated with partly satisfactory or unsatisfactory performance.

^b A loan is considered "at risk" if it is rated as "PS" or "U" in either implementation progress or development objectives, or if it is a potential problem loan.

Source: Asian Development Bank

Sector	Loan No.	Seq No.	Title	Cumulative Contracts/ Commitments (\$ million)	Cumulative Disbursements (\$ million)	Rating		Potential Problem ^a	At Risk ^b
						IP	DO		
EN	1983		Power Transmission Improvement Sector Project	4.8	2.5	S	S	No	No
HL	1810		Decentralized Health Services Project	40.6	36.4	S	S	No	No
HL	2074		Second Decentralized Health Services Project (DHS2)	0.1	1.9	S	S	No	No
HL	2075		Second Decentralized Health Services Project (DHS2)	0.0	1.0	S	S	No	No
IN	1978		Small and Medium Enterprises Export Development Project	7.7	12.2	S	S	No	No
LW	1678		Community and Local Government Support Sector Development Program (CLGSSDP)	83.0	83.3	S	S	No	No
LW	1964		Sustainable Capacity Building for Decentralization	8.0	1.4	S	S	No	No
LW	2126		State Audit Reform Sector Development Program	100.0	100.0	S	S	No	No
LW	2127		State Audit Reform Sector Development Program	0.0	2.5	S	S	No	No
LW	2192		Local Government Finance and Governance Reform Program	300.0	300.0	S	S	No	No
LW	2193		Local Government Finance and Governance Reform Sector Development Project	0.0	0.0	S	S	No	No
LW	2228		Development Policy Support Program	200.0	200.0	HS	HS	No	No
MS	1583	1	Rural Income Generation	19.6	20.0	S	S	No	No
MS	1583	2	Rural Income Generation	14.4	26.6	S	S	No	No
MS	1587		Metropolitan Medan Urban Development Project	57.8	51.1	S	S	No	No
MS	1765		Community Empowerment for Rural Development	26.7	18.0	S	S	No	No
MS	1765		Community Empowerment for Rural Development Project	24.2	23.6	S	S	No	No

ADF = Asian Development Fund; EN = energy; HL = health, nutrition, and social protection; HS = highly satisfactory; IN = industry and trade; IP = implementation progress; LW = law and public sector management; MS = multisector; No. = number; OCR = ordinary capital resources; PS = partly satisfactory; S = satisfactory; Seg = segment (pertaining to loans with more than one withdrawal authority); TC = transport and communications; DO = development objectives; HS = highly satisfactory; IP = implementation progress; S = satisfactory.

^a "Yes" for loans with four or more risk factors associated with partly satisfactory or unsatisfactory performance.

^b A loan is considered "at risk" if it is rated as "PS" or "U" in either implementation progress or development objectives, or if it is a potential problem loan.

Source: Asian Development Bank

Sector	Loan No.	Seq No.	Title	Cumulative Contracts/ Commitments (\$ million)	Cumulative Disbursements (\$ million)	Rating		Potential Problem ^a	At Risk ^b
						IP	DO		
MS	2072		Neighborhood Upgrading and Shelter Sector Project	0.0	1.9	S	S	No	No
MS	2073		Neighborhood Upgrading and Shelter Sector Project	13.0	0.1	S	S	No	No
MS	2163		Community Water Services and Health Project	0.0	0.0	S	S	No	No
MS	2164		Community Water Services and Health Project	0.0	0.0	S	S	No	No
MS	2221		Rural Infrastructure Support Project	0.0	0.0	S	S	No	No
TC	1798		Road Rehabilitation (Sector) Project	114.8	83.5	S	S	No	No
TC	2184		Road Rehabilitation II	0.0	0.0	S	S	No	No
Total				1,675.6	1,583.5				

ADF = Asian Development Fund; AG = agriculture and natural resources; ED = education; EN = energy; FI = finance; HL = health, nutrition, and social protection; HS = highly satisfactory; IN = industry and trade; IP = implementation progress; LW = law and public sector management; MS = multisector; No. = number; OCR = ordinary capital resources; PS = partly satisfactory; S = satisfactory; Seg = segment (pertaining to loans with more than one withdrawal authority); TC = transport and communications; WS = water supply, sanitation, and waste management; DO = development objectives; HS = highly satisfactory; IP = implementation progress; PS = partly satisfactory; S = satisfactory; U = unsatisfactory.

^a "Yes" for loans with four or more risk factors associated with partly satisfactory or unsatisfactory performance.

^b A loan is considered "at risk" if it is rated as "PS" or "U" in either implementation progress or development objectives, or if it is a potential problem loan.

Source: Asian Development Bank

Table A1.10: Assistance Pipeline for Lending Products, 2006–2009

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (million)				
						ADB		Gov't.	Co- financing	
						OCR	ADF			Total
2006 Firm Loans										
Agriculture and Natural Resources										
1. Sustainable Aquaculture for Food Security and Poverty Reduction		SEG	SEAE	2003		0.0	40.0	40.0	0.0	0.0
Subtotal						0.0	40.0	40.0	0.0	0.0
Education										
1. Madrasah Education Project	TI-M	ISD	SESS	2004		0.0	50.0	50.0	0.0	0.0
Subtotal						0.0	50.0	50.0	0.0	0.0
Law, Economic Management, and Public Policy										
1. Development Policy Support Program II	GI	SEG	IRM			200.0	0.0	200.0	0.0	0.0
2. Infrastructure Reform Sector Development Program I	GI	SEG	IRM			300.0	30.0	330.0	0.0	0.0
Subtotal						500.0	0.0	530.0	0.0	0.0
Transport and Communications										
1. Interisland Ports	GI	SEG/PSD	SEID	2002		47.0	0.0	47.0	0.0	0.0
Subtotal						47.0	0.0	47.0	0.0	0.0
Total						547.0	120.0	667.0	0.0	0.0
2007 Firm Loans										
Agriculture and Natural Resources										
Integrated Citarum Water Resources (MFF, \$500m), PFR1	GI	SEG	SEAE	2003		50.0	0.0	50.0	0.0	0.0
Subtotal						50.0	0.0	50.0	0.0	0.0
Education										
1. Senior Secondary Education	GI	ISD	SESS	2003		50.0	50.0	100.0	0.0	0.0
Subtotal						50.0	50.0	100.0	0.0	0.0

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (\$ million)				
						ADB		Gov't.	Co- financing	
						OCR	ADF			Total
Energy										
1. Energy Efficiency (MFF, \$250 million), PFR1	GI	SEG	SEID			100.0	0.0	100.0	0.0	0.0
Subtotal						100.0	0.0	100.0	0.0	0.0
Finance										
1. Financial Sector Governance and Social Security Reform Program II	TI-H	GOV	SEGF			200.0	0.0	200.0	0.0	0.0
2. Secondary Mortgage Facility, (MFF \$255m), PFR1	TI-M	PSD	SEGF	2005		50.0	0.0	50.0	0.0	0.0
Subtotal						250.0	0.0	250.0	0.0	0.0
Health, Nutrition, and Social Protection										
1. Nutrition Improvement and Community Empowerment	TI-M	ISD/GD	SESS	2003		0.0	50.0	50.0	0.0	0.0
Subtotal						0.0	50.0	50.0	0.0	0.0
Law, Economic Management, and Public Policy										
1. Development Policy Support Program III	GI	SEG/GD	IRM			200.0	0.0	200.0	0.0	0.0
2. Poverty Reduction and MDG Acceleration Program	TI-M	SEG/GD	SESS			200.0	0.0	200.0	0.0	0.0
Subtotal						400.0	0.0	400.0	0.0	0.0
Total						850.0	100.0	950.0	0.0	0.0
2008 Firm Loans										
Agriculture and Natural Resources										
1. Flood Management in Selected River Basins (MFF, \$150 million), PFR1	TI	SEG	SEAE	2003		50.0	0.0	50.0	0.0	0.0
2. Integrated Coastal Resources Management	TI	SEG	SEAE	2003		70.0	0.0	70.0	0.0	0.0
3. Urban Air Quality SDP	GI	ENV	SEID	2003		150.0	0.0	150.0	0.0	0.0
Subtotal						270.0	0.0	270.0	0.0	0.0

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (\$ million)				
						ADB			Gov't.	Co- financing
						OCR	ADF	Total		
Finance										
1. Secondary Mortgage Facility, (MFF valued at \$255 million) partial credit guarantee	TI-M	PSD	SEGF	2005		50.0	0.0	50.0	0.0	0.0
Subtotal						50.0	0.0	50.0	0.0	0.0
Law, Economic Management, and Public Policy										
1. Infrastructure Reform Program II	TI-M	SEG	IRM			300.0	0.0	300.0	0.0	0.0
2. Local Government Finance and Governance Reform SDP II	GI	SEG	SEGF			250.0	30.0	280.0	0.0	0.0
Subtotal						550.0	30.0	580.0	0.0	0.0
Multisector										
1. Community and Local Government Support II	TI-G	SEG/GD	SESS	2005		0.0	50.0	50.0	0.0	0.0
2. Integrated Settlements Development Project	TI-H	SEG	SESS	2003		50.0	0.0	50.0	0.0	0.0
3. Rural Infrastructure Support Project II	TI-G	SEG	SEAE			0.0	40.0	40.0	0.0	0.0
Subtotal						50.0	90.0	140.0	0.0	0.0
Water Supply and Sanitation										
1. Water Supply and Sanitation Subtotal	TI-M	ISD	SEID	2003		50.0	0.0	50.0	0.0	0.0
Total						50.0	0.0	50.0	0.0	0.0
2009 Firm Loans										
Agriculture and Natural Resources										
1. Flood Management in Selected River Basins (MFF, \$150 million), PFR2	GI	SEG	SEAE	2003		50.0	0.0	50.0	0.0	0.0
2. Integrated Citarum Water Resources (MFF, \$500 million), PFR2	GI	SEG	SEAE	2003		80.0	0.0	80.0	0.0	0.0
Subtotal						130.0	0.0	130.0	0.0	0.0

Sector Project/Program Name	Targeting Classifi- cation	Thematic Priority	Division	Year of Project Preparatory Assistance	Total	Cost (\$ million)				
						OCR	ADB ADF	Total	Gov't.	Co- Financing
Energy										
1. Energy Efficiency (MFF, \$250 million), PFR2	GI	SEG	SEID	N/R		100.0	0.0	100.0	0.0	0.0
Subtotal						100.0	0.0	100.0	0.0	0.0
Health, Nutrition, and Social Protection										
1. Community Water Supply and Health Services II	TI-G	ISD/GD	IRM	2008		20.0	30.0	50.0	0.0	0.0
Subtotal						20.0	30.0	50.0	0.0	0.0
Industry and Trade										
1. Neighborhood Upgrading and Shelter Project II	TI-H	SEG/GD	SESS	2007		0.0	80.0	80.0	0.0	0.0
Subtotal						0.0	80.0	80.0	0.0	0.0
Law, Economic Management, and Public Policy										
1. Development Support Program IV	GI	SEG	IRM			200.0	0.0	200.0	0.0	0.0
2. Financial Sector Governance and Social Security Reform Program III	TI-H	SEG	SEGF			200.0	0.0	200.0	0.0	0.0
3. Poverty Reduction and MDG Acceleration Program II	TI-M	SEG	SESS			200.0	0.0	200.0	0.0	0.0
Subtotal						600.0	0.0	600.0	0.0	0.0
Transport and Communications										
Regional Roads Project (MFF, \$250 million), PFR1	GI	ISD	SEID	2007		100.0	0.0	100.0	0.0	0.0
Subtotal						100.0	0.0	100.0	0.0	0.0
Water Supply and Sanitation										
1. Metropolitan Sanitation Management and Health Project	TI-M	ISD	SEID	2006		50.0	0.0	50.0	0.0	0.0
Subtotal						50.0	0.0	50.0	0.0	0.0
Total						1,000.0	110.0	1,110.0	0.0	0.0

ADB = Asian Development Bank; ADF = Asian Development Fund; Gov't = Government; ENV = environmental sustainability; GD = gender and development; GI = general intervention; IRM = Indonesia Resident Mission; ISD = inclusive social development; MDG = Millennium Development Goal; MFF = Multitranchise Financing Facility; OCR = ordinary capital resources; PFR = periodic financing request; PSD = private sector development; SEAE = Southeast Asia Agriculture, Environment, and Natural Resources Division; SEID = Southeast Asia Infrastructure Division; SESS = Southeast Asia Social Sector Division; TI-G = targeted intervention geographic; TI-H = targeted intervention individual/household; TI-M = targeted intervention support for MDG.

Source: Asian Development Bank

Table A1.11: Assistance Pipeline for Nonlending Products and Services, 2006–2009

Sector Assistance Name	Responsible Division	Assistance Type	Sources of Funding		Total (\$'000)	
			ADB			
			Source	Amount (\$'000)		Source
2006						
Agriculture and Natural Resources						
1	Integrated Citarum Water Resources Management (Supplementary)	SEAE	PPTA	300.0	0.0	300.0
2	Capacity Building for Water Resources Management under Decentralized Framework	SEAE	ADTA	1,000.0	0.0	1,000.0
3	Urban Air Quality Improvement SDP (Supplementary)	SEID	PPTA	300.0	0.0	300.0
	Subtotal			1,600.0	0.0	1,600.0
Education						
1	Madrasah Education Development	SESS	ADTA	1,000.0	0.0	1,000.0
	Subtotal			1,000.0	0.0	1,000.0
Law, Economic Management, and Public Policy						
1	Legal and Administrative Framework for Land Acquisition and Resettlement	SEID	ADTA	400.0	0.0	400.0
2	Pro-Poor Planning and Budgeting	SESS	ADTA	1,800.0	0.0	1,800.0
3	Strengthening the Capacity for Aid Effectiveness	IRM	ADTA	800.0	0.0	800.0
4	Support for Enhancing Infrastructure Provision	IRM	ADTA	1,800.0	0.0	1,800.0
	Subtotal			4,800.0	0.0	4,800.0
Water Supply and Sanitation						
1	Metropolitan Sanitation Management and Health	SESS	PPTA	1,200.0	0.0	1,200.0
	Subtotal			1,200.0	0.0	1,200.0
	Total			8,600.0	0.0	8,600.0

2007	Sector Assistance Name	Responsible Division	Assistance Type	Sources of Funding		Total (\$'000)		
				ADB			Others	
				Source	Amount (\$'000)		Source	Amount (\$'000)
Agriculture and Natural Resources								
1	Integrated Citarum Water Resources Management (Supplementary) ¹	SEAE	PPTA		600.0	0.0	600.0	
2	Flood Management (Supplementary) ¹	SEAE	PPTA		600.0	0.0	600.0	
	Subtotal				1,200.0	0.0	1,200.0	
Education								
1	Senior Secondary Education (attached)	SESS	ADTA		1,000.0	0.0	1,000.0	
	Subtotal				1,000.0	0.0	1,000.0	
Energy								
1	Energy Efficiency Project	SEID	PPTA		1,000.0	0.0	1,000.0	
	Subtotal				1,000.0	0.0	1,000.0	
Health and Nutrition								
1	HIV/AIDS in the transport sector	IRM	ADTA		800.0	0.0	800.0	
2	Nutrition Improvement through Community Empowerment (attached)	SESS	ADTA		800.0	0.0	800.0	
	Subtotal				1,600.0	0.0	1,600.0	
Industry and Trade								
1	Second Neighborhood Upgrading and Shelter Sector Project (NUSSP II)	SESS	PPTA		1,000.0	0.0	1,000.0	
	Subtotal				1,000.0	0.0	1,000.0	
Law, Economic Management, and Public Policy								
1	Financial Sector Governance and Social Security Reforms	SEGF	PPTA		1,000.0	0.0	1,000.0	
2	Infrastructure Reform Program	IRM	PPTA		1,000.0	0.0	1,000.0	
3	Investment Climate, Finance and Policy Reform Cluster	SEGF	ADTA		2,000.0	0.0	2,000.0	
4	Local Government and Governance Financing SDP II	SEGF	PPTA		1,000.0	0.0	1,000.0	
5	Physical Infrastructure Development Cluster	SEID	ADTA		2,000.0	0.0	2,000.0	

¹ To prepare subsequent Periodic Financing Request.

Sector	Assistance Name	Responsible Division	Assistance Type	Sources of Funding				Total (\$'000)
				ADB		Others		
				Source	Amount (\$'000)	Source	Amount (\$'000)	
6	Poverty Reduction and MDG Acceleration Cluster	SESS	ADTA		2,000.0		0.0	2,000.0
7	Support for Improved Disaster Risk Management	RSDD	ADTA		600.0		0.0	600.0
8	Support for Results Management in National Planning	IRM	ADTA		1,000.0		0.0	1,000.0
	Subtotal				10,600.0		0.0	10,600.0
	Transport and Communications							
1	Regional Road Development	SEID	PPTA		1,000.0		0.0	1,000.0
	Subtotal				1,000.0		0.0	1,000.0
	Total				15,200.0		0.0	15,200.0
2008								
	Agriculture and Natural Resources							
1	Community Driven Irrigation Project	SEAE	PPTA		1,000.0		0.0	1,000.0
2	Water Resources and River Basin Management Cluster	SEAE	PPTA		2,000.0		0.0	2,000.0
3	Urban Air Quality Management	SEID	ADTA		1,000.0		0.0	1,000.0
	Subtotal				4,000.0		0.0	4,000.0
	Energy							
1	Energy and Power Development	SEID	PPTA		1,500.0		0.0	1,500.0
	Subtotal				1,500.0		0.0	1,500.0
	Health and Nutrition							
1	Community Water Supply and Health Services II	SESS	PPTA		1,000.0		0.0	1,000.0
	Subtotal				1,000.0		0.0	1,000.0
	Law, Economic Management, and Public Policy							
1	Governance and Anticorruption Cluster	SEGF	ADTA		2,000.0		0.0	2,000.0
2	Local Government Finance and Governance Reform	SEGF	ADTA		500.0		0.0	500.0
6	Poverty Reduction and MDG Acceleration Program	SESS	PPTA		1,000.0		0.0	1,000.0
	Subtotal				3,500.0		0.0	3,500.0
	Multisector							
1	Enhancing Impact of Rural Infrastructure Development (attached to RISP II)	SEAE	ADTA		600.0		0.0	600.0
	Subtotal				600.0		0.0	600.0

Sector Assistance Name	Responsible Division	Assistance Type	Sources of Funding				Total (\$'000)
			ADB		Others		
			Source	Amount (\$'000)	Source	Amount (\$'000)	
Transport and Communications							
1 Toll Road Development	SEID	PPTA		1,000.0		0.0	1,000.0
Subtotal				1,000.0		0.0	1,000.0
Total				13,600.0		0.0	13,600.0
2009							
Agriculture and Natural Resources							
1 Integrated Citarum Water Resources Management (Supplementary) ¹	SEAE	PPTA		600.0		0.0	600.0
2 Flood Management (Supplementary) ¹	SEAE	PPTA		600.0		0.0	600.0
3 Improved Governance and Participatory Irrigation Management Cluster	SEAE	ADTA		2,000.0		0.0	2,000.0
4 Integrated River Basin and Irrigation Management Project	SEAE	PPTA		1,000.0		0.0	1,000.0
5 Marine Environment and Biodiversity Conservation Cluster	SEAE	ADTA		2,000.0		0.0	2,000.0
6 Natural Resources Management in the Decentralized Context	SEAE	PPTA		1,000.0		0.0	1,000.0
Subtotal				7,200.0		0.0	7,200.0
Law, Economic Management, and Public Policy							
1 Infrastructure Reform Program	IRM	PPTA		1,000.0		0.0	1,000.0
2 Support to the Decentralization Cluster	SEGF	ADTA		2,000.0		0.0	2,000.0
Subtotal				3,000.0		0.0	3,000.0
Total				10,200.0		0.0	10,200.0

ADB = Asian Development Bank; ADTA = advisory technical assistance; HIV/AIDS = human immunodeficiency virus/acquired immunodeficiency syndrome; IRM = Indonesia Resident Mission; MDG = Millennium Development Goal; NUSSP = Neighborhood Upgrading and Shelter Sector Project; PPTA = project preparatory technical assistance; REG = regional; SDP = Sector Development Program; SEAE = Southeast Asia Agriculture, Environment, and Natural Resources Division; SEID = Southeast Asia Infrastructure Division; SESS = Southeast Asia Social Sector Division.
Source: Asian Development Bank

¹ To prepare subsequent Periodic Financing Request.

PROCESS OF COUNTRY STRATEGY AND PROGRAM PREPARATION

1. The preparation of the country strategy and program (CSP) for Indonesia involved an analytical and consultative process that took almost 2 years. The start of the process coincided with the first direct Presidential elections, and installation of a new cabinet under President Yudhoyono. The Aceh and Nias earthquake and tsunami took place during the new president's first 100 days in office and absorbed most government and Asian Development Bank (ADB) resources for an extended period of time. ADB's initial consultations with the Government did not get under way until May 2005. The Government's objective was to improve the planning and coordination of foreign assistance, and to draw up debt management and borrowing strategies. These were finalized in the first half of 2006, following extensive internal consultations.

2. ADB's initial consultations with the Government focused on its views on borrowing for development projects. Since the financial crisis of 1997/98, the Government has been focused on reducing the national debt, and there has been a growing concern about the effectiveness of projects financed by foreign loans. Other meetings focused on issues concerning the provision of support in a decentralized environment and on infrastructure development. These initial consultations formed the basis for a continued dialogue between the Government and ADB missions, for the CSP and also for the various programs under preparation. Further formal consultations took place in early 2006, based on the Government's revised borrowing strategy. After the realignment of ADB's former Southeast Asia Department (SERD) and the former Mekong Regional Department (MKRD), the Southeast Asia Management Team held a two-day retreat in Jakarta in June 2006, followed by consultations with the Government at all levels.

3. Selected provincial and district governments were consulted on the proposed ADB strategic framework and sector focus. Two issues took prominence: the need for infrastructure investments, and the lack of clarity in the central government on the fiscal decentralization framework, especially related to the ability of local governments to onlend and ongrant ADB loans, for which the rules were not always as clear. ADB's role in social development and in capacity building was much appreciated, but implementation delays were often caused by delays at the center. The continued dependence on the center and the weak capacities in local governments were evident during these consultations.

4. Consultations with nongovernment organizations (NGOs) outside Jakarta showed that governance is still weak at the local level, because of the weak capacities of the executive and legislative powers. There often appear to be conflicts of interests among the local elites in the selection of new development projects such as roads. Civil society is not readily able to influence local governance as it has limited resources and access to information. NGOs expressed the need for more information on ADB operations and on how they are performing. Concerns were also expressed over the destruction of natural resources, including forests, fisheries, and coastal resources. Natural resources are negatively affected by commercial developments such as luxury houses and shopping malls. While water resources management is a problem in many areas, institutional arrangements for water resources management have become very complex since decentralization. Many NGOs expressed the view that communities and the private sector have an important role to play in development activities, provided there are clear accountability mechanisms established.

5. Other donors in Indonesia were consulted in the preparation of the CSP. Some of these consultations were part of an ongoing harmonization process with ADB's partners, including the World Bank, Japan Bank for International Cooperation (JBIC), and the Department for International Development of the UK (DFID). Others were part of a targeted CSP consultation

process. These consultations resulted in valuable feedback, and identification of potential co-financing opportunities. Discussions also focused on the possibility of harmonizing strategy preparation. However, this may be a long-term effort, given the evolving situation in Indonesia, and the varying time frames that donors are working with.

6. Consultation with civil society is a continuous process for the ADB Indonesia Resident Mission (IRM). In the past, many NGOs have been highly critical of ADB's lending to Indonesia, which was a perceived source of corruption. The anti-debt coalition remains strong. During consultations with civil society undertaken since early 2004, it became clear that there is a growing understanding by many (but not all) NGOs that loans can be utilized effectively, and that ADB is striving to improve its effectiveness. A recurrent theme for NGOs (principally those based outside Jakarta) is the difficulty of obtaining any information from the Government about plans for ADB financing of projects in their district or provinces. The new ADB public communications policy was explained to these NGOs and this should help to address these concerns. Another common concern was the perceived corruption in local governments and the potential role of NGOs in reducing such corruption was discussed.

7. The CSP team was extensively consulted during the formulation of the country assistance program evaluation¹ (CAPE), which took place during most of 2005, and was discussed in the Development Effectiveness Committee in January 2006. The team benefited from the discussions, during which it became clear that there was a need for ADB operations in Indonesia to be better focused in order to enhance their effectiveness, increase private sector participation, and reduce transaction costs.

8. A matrix showing the CAPE recommendations and issues raised by the Development Effectiveness Committee during its discussion of the CAPE are in Table A2. During the CSP preparations, the Government also gave its views on how ADB operations could become more relevant to its programs. Box A2 below shows how the CSP has responded to these views.

¹ ADB. 2006. *Country Assistance Program Evaluation*. Manila.

Box A2: How the Country Strategy and Program Addresses the Government's Views on Improving ADB's Relevance

The country assistance program evaluation (CAPE) for Indonesia included the Government's view on how the Asian Development Bank (ADB) could become more relevant (page 53, Box 14). This is how this country strategy and program (CSP) addresses these suggestions.

Allow a Longer Time for Project Preparation. The size of project preparatory technical assistance (PPTA) projects has increased to at least \$1 million, and as a rule there is always at least 1 year between PPTA approval and the ensuing loan approval.

Improve Quality at Entry and Project Readiness. Loans will only be negotiated once it is clear that they meet the Government's project readiness criteria.

Improve Portfolio Management. The Indonesia Resident Mission (IRM) continues to make efforts to improve portfolio management, which has resulted in a sharp reduction in the number of projects at risk.

Increase Government Ownership of Policy Reforms. The agreed reform agenda in the CSP is largely based on the Government's own reform programs, derived from various inter-ministerial working groups.

Improve the Effectiveness of TA. In the CSP, ADB is moving toward a more flexible approach to TA through clusters. This will allow ADB to be more responsive to Government needs, and also to take more account of the Government's inputs on consultant selection.

Increase the Role of the IRM. Originally established to help supervise projects, the IRM has increasingly expanded its functions to include country strategy and program formulation, processing of program loans and technical assistance, and provision of policy advice. Its role is currently under review in the context of ADB's review of the resident mission policy and the evolving situation in Indonesia, which will have implications for staffing resources and the skills mix at the IRM.

Support an Enabling Environment for the Private Sector. This is a major expected outcome of the CSP, embedded in the growth pillar (infrastructure and financial sector support), and the governance area (improved public sector management, and anticorruption activities).

Introduce New Products and use the Capital Market. The CSP will make full use of ADB's new financing modalities, including the issuance of local bonds and local currency financing.

Source: Asian Development Bank

Table A2: Country Assistance Program Evaluation (CAPE) and Development Effectiveness Committee (DEC) Recommendations and the Country Strategy and Program (CSP), 2006–2009

CAPE Recommendations	CSP
<p>1. CSP should identify niches to alleviate principal constraints, the areas of decentralization, governance and anticorruption, increasing investments for the provision of public goods, and building an environment for the private sector.</p>	<p>The CSP focuses on:</p> <ul style="list-style-type: none"> • facilitating private sector development, including greater private sector participation in infrastructure provision, • strengthening fiduciary and operational governance of key public and private institutions—through direct and dedicated programs and projects (e.g., State Audit Reform and Local Government Financing and Governance Reform), as well through a strong fiduciary focus in all projects, and • enhancing capacity, particularly at local government levels, to improve the delivery of public services. <p>The process of formulating the CSP included close collaboration between public and private sector departments, emphasizing potential synergies.</p>
<p>2. The CSP should select key focus areas based on: ADB's track record; mainstreaming governance; and geographic operation.</p>	<p>In accordance with the track record of ADB, the key focus areas include energy, transport, water supply and sanitation, finance, public financial management, education, health and nutrition and water resources management. Most projects will address governance-related issues, while increased attention will be paid to anticorruption measures in individual projects. The national government is very reluctant to adopt a geographic focus for lending operations. Given the demand-driven nature of projects, having a geographic focus could be counter productive.</p>
<p>3. Coverage of CSP should be consistent with ADB resources. Give consideration to: redeployment; strengthening IRM skills mix; and stationing adequate numbers of international staff.</p>	<p>The Government has been quite clear in its preference for greater program lending support, with additional project support to cover a limited set of sectors and priorities. The Government recognizes that the quality of reform packages is of utmost importance. To an important extent, these requirements must shape ADB's own staffing plans, and the allocation of resources to the IRM.</p>
<p>4. Need to reduce transaction costs by using validated country information systems, coordinating with external development partners and limiting amount of data collected.</p>	<p>The Rural Infrastructure Support Project was the first project to make full use of country systems, and other projects in the program will explore this option. Other support to local governments, especially in the social sectors, will go through existing country systems, as the traditional project modality is too costly and ineffective.</p> <p>There has been much greater harmonization in the last 2-3 years in data collection and analytical efforts between the principal development partners. Joint financing of major policy-based operations has helped in this regard. In particular, ADB, the World Bank, the United States Agency for International Development (USAID) and others are collaborating in local government performance measurement.</p>
<p>5. ADB must make efforts to provide better services to the client.</p>	<p>There is momentum for change from both directions. Indonesia is articulating its emerging position as a middle-income country quite clearly. On ADB's side, the adoption of new products and financial</p>

CAPE Recommendations	CSP
6. Greater private sector participation (PSP) is vital: PS operations; cofinancing; and more attractive products will be needed.	<p>modalities offers the right tools to respond with. ADB recognizes that reducing the Government's transaction costs of dealing with donors is a Government priority. One area is the Government's request for clustering program loans to provide predictability as well as continuity. The Government is also requesting greater use of "programmatic" modalities, which would use the Government's own project implementation and procurement systems as the basis. There is also a clear focus on greater harmonization between the Government's systems, procedures and policies, and those of ADB and other development partners.</p> <p>Enhancing PSP is the cornerstone of the CSP. There are significant opportunities in infrastructure sectors. The new products arising from ADB's innovation and efficiency initiative (IEI) will also enable changes to be made to state-owned enterprises (SOEs), including facilitating greater PSP.</p>
Development Effectiveness Committee Recommendations	
The CAPE recommendation to identify four niche areas should not limit where the Government sees a role for ADB.	In the discussions with the Government, it expressed a clear view of where it would expect support from ADB, and this is reflected in the CSP. Hence it includes social development (acceleration toward achieving the Millennium Development Goals), rural development and infrastructure, and environment and natural resources management.
Box 14 on page 53, containing the Government's view on how ADB assistance could become more effective, needs to be dealt with upfront in the CSP	See Box A2.
The CSP needs to contain a section explaining how the strategy has been translated into an operational program	See main text, Section IV.
The CSP needs to contain a section explaining how lessons learned from past portfolio performance are taken into account	See main text, Section IV, especially Table 2.
The CSP should contain an Annex documenting the DEC's recommendations, with an explanation of how DEC's recommendations are taken into account.	See this appendix.

ADB = Asian Development Bank; CAPE = Country Assistant Program Evaluation; CSP = Country Strategy and Program; DEC = Development Effectiveness Committee; IRM = Indonesia Resident Mission; PS = Private Sector; PSP = Private Sector participation; SOE = State Owned Enterprises.

Source: Asian Development Bank

ASSESSMENT OF RESULTS MANAGEMENT CAPACITY IN INDONESIA

1. This appendix provides a rapid assessment of results management capacity by looking at the five key building blocks of results management: (i) commitment, norms and values for results management; (ii) clarity of expected results; (iii) making results happen by linking objectives and planning; (iv) determining contributions to results through monitoring and evaluation; and (v) making results matter by providing feedback on decision making. The assessment was used in the preparation of this CSP, and will be further elaborated during the preparation of the CSP. This assessment focuses primarily on the central government as the primary provider of resources to all levels of government. Given the variety and diversity of local governments (of which there are about 440), conducting assessments at that level would be very resource-intensive. However, assessments of local governments where ADB has relevant projects, such as districts where the Local Government Finance and Governance Project has major activities, will be made during the CSP period. Such assessments can then be reflected in CSP progress reports. However, as long as local governments have little discretion in their spending, the value of such assessments will remain limited. Clearly, the main driver for results and for assessing results is the budget process. While central institutions, such as line ministries, are embarking on an improved budget process within a 3-year performance based budgetary framework, the way local governments are financed will make it difficult to replicate this at that level.

A. Commitment, Norms, and Values for Results Management

2. Indonesia has successfully made the transition from an authoritarian state with centralized management of the economy to a full-fledged democracy with a decentralized structure. Given the speed with which this transformation has taken place, especially in terms of developing the necessary legal and regulatory framework, it is not surprising that the implementation of these reforms, and especially the required capacity development, will take time. Nevertheless, Indonesia is well on the way to introducing the important building blocks for results management. The commitment to results management is clearly reflected in the Law on State Finance (Law No.17/2003), which is the first law to provide the legal basis for performance-orientation in public sector resource management in Indonesia. The principal goal of the law is to improve efficiency, transparency and accountability in the use of state finances. It aims to integrate macroeconomic planning and fiscal policy formulation, besides enhancing overall accountability of the budget process. The law requires each line ministry and budget institution to submit a work plan together with its budget proposal. Subsequently, Parliament also enacted the Law on State Treasury (Law No.1/2004) and the Law on State Audit (Law No.15/2004). Together, these three laws could potentially cover the full budget cycle. However, the norms and values for the effective implementation of these laws are currently lacking, as the civil service at large has not been subject to similar reforms, and is firmly stuck in “business as usual” mode, with little incentive to change. Furthermore, full adoption of a functional performance-based management (PBM) system is a formidable task, one that has been challenging even in developed countries. It is commendable that Indonesia has begun its transition toward PBM. While line ministries are submitting annual work plans, they vary in quality and the level of details. The transition process toward a full PBM system is likely to be long.

B. Clarity of Results

3. The medium-term development plan (RPJM, 2005–2009) provides a clear set of higher level targets that the Government wants to achieve by the end of the period. Among them are

sustained growth of more than 6%, job creation to absorb 1.5 million new entrants into the labor market annually, achievement of Millennium Development Goal (MDG) targets, and a reduction in the stock of debt to 31.8% of GDP. The Government is holding itself accountable to parliament and the public for achieving these targets. Based on the RPJM, the Government prepares an annual work plan (RKP) that sets more specific targets for the year, and is used as an input into the budget process. The RPJM sets out a good policy framework for the required reforms and investments for each sector.

4. At local levels, minimum service standards (MSS) have been issued for decentralized functions. ADB has supported the process of developing these standards,¹ which are not yet operational more than 5 years into the decentralization process. Law 32/2004 on Regional Autonomy stipulates that the obligatory functions assigned to local governments need to be evaluated against certain minimum service standards. The lack of clarity in the assignment of functions and concerns over fiscal constraints that may impede the attainment of MSS led to delays in implementing the standards. This is also due to the fact that MSS were originally conceived as administrative standards without links to the budget.

C. Linking Objectives and Planning

5. A key aim of the Law on State Finance is also to move Indonesia toward a medium-term expenditure framework (MTEF, with effect from 2008). To support this process, the law also stipulates there should be a transition to accrual accounting. In practical terms, both requirements pose major challenges. PBM needs to be gradually and progressively integrated into an MTEF. The Government is slowly adopting a combination of top-down and bottom-up approaches, based on a system of expenditure projections. The line ministries are currently required to submit their budgetary requirements according to a rolling 2-year cycle. This needs to be gradually expanded into a 3-year process, before a full-fledged MTEF takes shape. However, most line ministry budgets are not sophisticated enough to identify the costs associated with the delivery of programs and policies. The eventual adoption of accrual accounting could help in this process.

6. In September 2004, Parliament enacted the Law on National Development Planning (Law No.25/2004) outlining a system of annual work plans at both national and local levels to ensure greater harmonization between annual budget preparation, and outputs and outcomes. To help implement these laws, the President has approved two key government regulations on the government work plan (PP. No.20/2005) and budgeting (PP. No.21/2005). The regulatory framework on work plans attempts to define performance, although improvements are needed on this front. In addition, the Government has adopted the Government Finance Statistics Manual (2001), which paves the way for a move toward unified performance-based budgeting.

7. At the local government level, the picture is somewhat different. The general allocation fund (DAU), which is the main source of funding for most local governments, is a formula-determined block grant intended to finance decentralized functions and services, including civil service wages and other overheads. In theory, the block grant mechanism allows receiving regional governments to decide on their own priorities. However, the majority of regional governments receive just enough DAU funds to cover basic salary and administrative costs, making it impossible for them to link their development objectives to planning and budgeting. A

¹ ADB. 2002. *Local Government Provision of Minimum Basic Services for the Poor*. Manila (TA 3967-INO).

further problem is the lack of accountability inherent in this kind of block grant. For example, education is a national priority and local governments are expected to allocate sufficient finance to it. While many local governments do prioritize education, others may choose to do otherwise, e.g. to build new administrative buildings or buy new cars. They can do so without being held accountable as long as the financing comes from unconditional block grants. With this kind of financing mechanism for local governments, the capacity for managing for results remains a serious challenge.

D. Monitoring and Evaluation

8. Although the statistics system has traditionally been strong, monitoring and evaluation is a major weakness of the government planning system. Feedback on progress and results achieved is rarely provided, despite the numerous requirements for forms to be filled out and filed. Most of these forms are for recording purposes only, not for monitoring progress and evaluating results. A possible exception is the monitoring of progress towards the MDGs, where the international community has provided strong support. Additionally, the central government requires local governments to prepare poverty reduction strategies, where progress towards the MDGs is reported at the local level. The Government has shown strong interest in strengthening monitoring and evaluation, but will require substantive technical support to achieve this.

E. Feedback of Results Information to Decision Making

9. There is a strong tradition in Indonesia of basing decisions—at least in part—on the available information, either from the statistics system, or through special studies. However, more often than not, decisions are also based on informal feedback received from the field through the civil service system. This means that there is a fertile ground for using results-based information in the decision-making process, although at present there is a lack of such information and this needs to be addressed.

F. Conclusions

10. The potential for effective results management in Indonesia is firmly embedded in the prevailing legal framework. Since 2003, the Government has firmly put in place a number of processes that will eventually lead to a strong results management system. The biggest challenge is the absence of any genuine attempts at civil service reform, or to put in place an alternative incentive system. Without such changes, the capacity for results management will remain weak. The Government has not asked for donor support for studying and initiating civil service reforms, but should such a request come, ADB will be ready to provide support where needed and effective.

Country Poverty Assessment

1. Poverty Profile of Indonesia

1. The poverty headcount in Indonesia has been steadily falling since the post-crisis level of 23.4% of the population in 1999. At the end of 2004, the official poverty incidence was just 16.7%, representing more than 36 million people, a significant number by any standard. As of March 2006, the poverty incidence had increased to 17.8%, mainly as a result of the large fuel price increases following a cut in subsidies in March and October 2005. In 2004, the average national poverty threshold was Rp122,775 per person per month (about \$13.73). The poor continue to be concentrated in rural areas (the rural poverty headcount was 20.1% in 2004). However, Indonesia is rapidly urbanizing. In 2000, about 42% of Indonesians lived in urban areas. By 2025, 68% are projected to do so.

2. Regional disparities are significant, and the provinces with the highest poverty headcounts are not the same as those with the greatest number of poor people. East Java has the largest number of poor people (about 7.3 million in 2004), but its headcount was only 20.1%. The less populated eastern provinces have the highest headcounts but a far smaller number of poor. Regional disparities can be grouped into three broad categories: between Java and the rest of Indonesia, between east and west Indonesia, and between urban and rural areas. However, delving into the data, the picture is much less clear. Disparities between Java and Sumatra, for example, are considerable, as well as among districts in Java.

3. The rapid rise of poverty during the crisis highlights people's vulnerability to shocks. The large proportion of poor and near-poor clustered around the poverty line fall below it in response to even minor setbacks such as price and weather fluctuations and are unable to accumulate capital to improve their welfare and to cushion downturns.

4. Not all poverty is the same. The rural and urban experiences differ. No information is available about intra-household impacts and the differential impacts between men and women, adults and children, and the elderly. Some generalizations can be made about the differences between areas with high and low levels of poverty. The Foster-Greer-Thorbeck index, which shows the depth of poverty, indicates that regions with high incidence of poverty have a greater proportion of ultra-poor. Conversely, those with a low incidence of poverty have proportionally more households clustered around the poverty line. Some implications are that social security is needed for those near the poverty line and social protection for those well below.

2. MDGs and Prospects

5. The poverty headcount index is only of the many measures of poverty. The MDGs focus on the broader dimensions of well-being, including hunger and access to education, health, gender equality, safe water and sanitation, and shelter. On the whole, Indonesia is making solid progress toward achieving the MDGs, particularly in relation to poverty reduction, education, gender equality, and child mortality. But this positive general prognosis masks a more complex reality, where nationally aggregated statistics fail to capture the degree of underdevelopment among the regions and the unevenness of MDG attainment. The greatest MDG challenges are for the environment and health. There are an estimated 582,000 new cases of tuberculosis each year, for example, and maternal mortality rates remain high. The lifetime risk of a woman dying of causes related to childbirth in Indonesia is estimated to be 1 in 65, as compared with 1 in 1,100 in Thailand or 1 in 8,000 in Germany.

3. Institutions, Markets, and Decentralization

6. The labor market is largely informal and flexible, with people shifting sectors in response to season and availability of work. Since 1997, slow job growth has been unable to absorb the nearly 2.5 million new labor force entrants each year. Unemployment has been growing, reaching 9.9% or 10.8 million in 2005. It is highest among youth, women, and those with higher levels of education (senior high school and above). Job seekers fall into two categories: (i) the young and more educated, who can afford to wait for a suitable job; and (ii) the poor and unskilled, who cannot afford not to work.

7. Because of low productivity, formal employment does not assure escape from poverty. Nearly 20% of formal sector workers are poor. Formal employment has declined in the face of low investment and the increasing minimum wage. The growth of wages has outstripped value added. The general labor force has little education and poor skills. The average prime-age worker, 25 to 54 years old, has less than 8 years schooling. While Indonesia has made great strides, its comparators have progressed faster. As a result, Indonesian workers compete with workers at the bottom end of the economic scale, from Cambodia, India, and the PRC.

8. More than 90% of Indonesia's businesses are micro- and small enterprises. Their growth, and the jobs they would then create, is important to reduce poverty. But new microenterprises and small start-up firms are seldom able to obtain formal credit because of their highly uncertain business plans, unregistered nonlegal status, and their need for small loans, which require a large spread between interest rates and the cost of capital. Small enterprises are plagued by an inability to pledge collateral or property as a guarantee of repayment, and an inability to assemble own-equity to fund a portion of the overall investment. No prudent bank is willing to fund 100% of a proposed new investment and to assume all the risk.

9. A limited geographic network also reduces access to financial services to rural enterprises. Nonbanking institutions also mobilize savings among the poor, intermediate with banks, and channel resources to the poor. Community self-help groups also provide an economic safety net for group members. Efforts have been made to increase the scope of financial services down to the poor but have experienced problems with targeting and implementation. Other significant constraints are availability of raw material, and knowledge of marketing, technical production, and management.

10. Improved access to important services is the key to reducing poverty and achieving the MDGs. Decentralization can improve welfare by bringing service delivery closer to the people, especially to the poor. The legal framework for decentralization, however, is unclear, and the public service standards cannot be met with the resources allocated. Development of local governments' capacity to implement their responsibilities remains a key challenge of decentralization, particularly in service delivery. Local communities also require capacity development, as they lack information about development plans, budget allocations, and their entitlements to social services.

4. Causes of Poverty

11. The causes of poverty according to the PRSP are the lack of access to (i) quality, affordable food; (ii) quality health services; (iii) quality education services; (iv) jobs and business opportunities; (v) housing and sanitation services; (vi) clean water; (vii) natural resources, and a deteriorating environment ; as well as (viii) an absence of land rights; (ix) violent conflict; and (x) a lack of participation. These causes can be interpreted as a lack of access to various forms of human, physical, financial, natural, and social capital. Three other factors contribute to poverty: inadequate infrastructure, lagging agriculture, and vulnerability. More than half of all Indonesians lived below the \$2/day international poverty line in 2002.¹ Small changes in income can have major welfare implications for vulnerable families.

12. Indonesia's infrastructure sector is deteriorating: electrification rates are the lowest in the region (at 53%) and road network congestion is increasing. When local governments were given control over local infrastructure, they were not provided with adequate funds for investment. Geography has a large impact on access to services and poverty. The low population density outside of Java, the poor interisland and road network, and the concentrated nature of industry and trade results in poorly integrated markets. Interregional trade barriers, local monopolies, and poor market information worsen the terms of trade between prices paid for consumer goods and prices received for goods produced for people living far from market centers. Poor physical access reduces access to basic services. With improved access, teachers might be more willing to staff poor rural schools, increasing human capital. Agriculture extension workers would be able to reach rural farmers, providing technical advice and know-how to increase productivity. Rural villagers could reach health stations, and child mortality might be reduced.

13. By the mid-1990s, success in agricultural development resulted in complacency, and the momentum to expand in modern crop varieties, irrigation, fertilizer, and other inputs was lost. Government priorities shifted away from agriculture, the quality of public sector economic management weakened, and investments in agriculture and the rural sector declined. Deteriorating world prices for basic commodities such as rice further reduces the return to agriculture. More international price competition, higher land values from population growth and urbanization, increased environmental pressure, and a less predictable climate increases the susceptibility of farmers and agricultural workers to shock. Vulnerability to shock is a fact of life for the large segment of the population clustered around the poverty line, and small changes in income can have a major effect on the welfare of vulnerable families.

5. Government Poverty Reduction Policies and Program

14. Poverty reduction is a major Government priority, but its basic philosophy has changed. The Government no longer sees growth as the driver of poverty reduction, but rather human development as the driver of growth. The Government's Poverty Reduction Strategy Paper (PRSP) has been incorporated into the Medium-Term Development Plan (RPJN). The objectives of the PRSP are to (i) establish Indonesia's commitment to reduce poverty, (ii) build consensus on poverty eradication, (iii) underline commitment to achieving the MDGs, and (iv) synchronize poverty reduction activities. In the PRSP, poverty reduction strategies are

¹ The international poverty lines of \$1 and \$2/day are converted into rupiah using 1993 purchasing power parity (PPP) exchange rates. It is important to note that \$2 converted into rupiah using the 1993 PPP exchange rate are worth far less than \$2 converted to rupiah at the current (2005) exchange rate. In the IMF World Economic Outlook Database (April 2005) the implied PPP conversion rate per US dollar is just 2,535 rupiah for 2005. The current US dollar exchange rate Rp9,089.

increasingly localized as local governments are encouraged to set up poverty reduction committees and to prepare poverty reduction strategies. Further capacity development for local governments will be key to their success. To implement the PRS, the Government is working with civil society and the private sector to prepare a social contract focusing on four priority basic rights: food security, education, health, and safety and social cohesion to provide a road map for all stakeholders.

15. Indonesia has a history of implementing strategies to accelerate poverty reduction. Initial strategies focused on geographic targeting. Individual and household targeting followed but was severely constrained by the scope and accuracy of the data. Self-targeting programs, where the poor select themselves for benefits, have been more successful. These benefits are inferior goods (such as low-quality rice), inferior job opportunities (unskilled jobs, with wages set below market rates), or goods and services consumed mostly by the poor (and which are readily substituted with superior goods once incomes rise). The labor-intensive public works programs—with wages well below the regional minimum wage for construction projects—have been effective in reaching the income-poor.

6. Conclusions and Recommendations for Achieving a Prosperous Indonesia

16. The ADB poverty reduction strategy²—pro-poor economic growth, inclusive social development, and good governance—provides the context for poverty reduction. Better access to services is key to reducing poverty. Prioritizing investments in human capital (education and health) and in physical capital (infrastructure services) will go a long way toward promoting economic growth and poverty reduction. Targeted programs will always be necessary for the poorest. Targeted programs with dual benefits are conditional cash transfers, with the short-term goal of income support and the longer-term goal of poverty reduction through increased human capital. To that end, improved local data is needed to improve targeting of resources and programs to the poor. This is particularly important given the context of decentralization, in which local governments now have primary responsibility for poverty reduction.

² ADB. 1999. *Poverty Reduction Strategy*. Manila

B. Governance and Anticorruption Assessment

1. Introduction

17. The purpose is to describe key issues and challenges that Indonesia is facing in its efforts to combat corruption as well as the Government's response to these challenges. The road map suggests how ADB should focus its work with the Government and other stakeholders to help fight corruption.

18. ADB has participated in the regular meetings of the Working Group on Anticorruption, one of the joint working groups under the Consultative Group for Indonesia and chaired by the Partnership for Governance Reform, and has consulted with the Commission for Eradication of Corruption in Indonesia (KPK) as well as with other stakeholders, including multilateral and bilateral funding agencies. Because of the current political anticorruption focus and subsequent momentum for reform, all major donors are focusing on corruption and on how to support efforts against it in an effective and well-coordinated way.

2. Current Situation—Summary Analysis

19. Fighting corruption is prominent in the Government reform agenda, and the President himself has confirmed many times that it is his first priority. While comprehensive anticorruption legislation has been in place for several years, it was only in 2005 that it began to be seriously enforced. During previous governments, business as usual with lack of accountability and even impunity for public officials was not challenged and rigged court verdicts were not questioned, except in a few highly publicized cases. Today, however, President Yudhoyono's focus on fighting corruption, combined with the success of KPK, has changed the climate: corruption is now investigated and prosecuted to an extent not previously seen.

20. In addition to KPK, the President has set up a taskforce with representatives from the National Police and Attorney General's Office (AGO) to focus on corruption cases. In late 2004, the President issued an instruction (Inpres 5/2004), and the National Action Plan for Eradication of Corruption (RAN-PK) was issued a few months later. At the regional level, corruption cases, often with the support of the Partnership for Governance Reform, have been investigated and prosecuted including several high-profile cases against regional assembly (DPRD) members or even against whole DPRDs. It is clear that the previous lack of accountability and impunity for public officials are no longer accepted.

21. General anticorruption laws and institutions punish perpetrators, but they do not address the roots of corruption or necessarily do away with the prevailing "corruption culture". Eradication of corruption is a more complex and demanding process than prosecuting perpetrators. To be fully effective, the fight against corruption requires preventive activities addressing fundamental elements of the governance system as well as the behavior of individuals operating within or in contact with it. Indonesia needs to focus on reforming its crosscutting government functions such as public expenditure management, including audit and procurement; the regulatory process, including effective implementation and enforcement of enacted legislation; and civil service management, particularly in the light of regional autonomy.

22. KPK, which is an island of integrity in the state apparatus, had a successful year 2005, with many high-profile cases investigated and prosecuted, clearly confirming the seriousness of the Government's commitment but having little impact on the behavior of public officials in central agencies as well as in the 33 provincial and 440 local administrations. KPK has so far

been a Jakarta-bound institution with little outreach to the regions, where local elites in many cases do business as usual. The impact of Inpres 5/2004 and RAN-PK has so far been limited. A few institutions have issued new policies under Inpres 5/2004 on, for example, asset declaration, performance evaluation, and procurement. But the policies have been few and their impact marginal as they are issued in an administrative system in need of fundamental and radical reforms. The fact that Inpres 5/2004 only covers the executive branch, leaving the judiciary, the legislature, and political parties outside its reach, further limits its impact.

23. On 20 March 2006, DPR ratified the UN Convention Against Corruption. This means that KPK now has to fulfill the role of a central anticorruption body as defined in the UN Convention. KPK now has to focus on its corruption prevention mandate in addition to its repressive mandate, i.e., investigation and prosecution. To that end, KPK has proposed to the President a master plan for comprehensive governance reform, including civil service reform in the executive, judicial, and legislative branches. The President, in a Cabinet meeting, has approved the reform proposal in principle. KPK's role will be to facilitate and push for reform but not to participate in implementation, which instead will be lead and coordinated by the President's Delivery Unit (PDU). The PDU head will report to the President. The PDU will help the President make agreements on delivery targets and reform targets with selected public institutions. Progress in relation to these targets will be monitored by the PDU.

24. A limited number of progressive local governments have taken on reform of their own administrations, including its business processes, staffing, and human resource management. The scope for such reforms is, however, limited by rigid civil service regulations, and the reforms will not become sustainable unless they are combined with central regulatory reform. The minister of finance has recently started reforms of tax and customs directorates to curb corruption and improve performance. She also intends to review salary conditions for the highest officials to improve transparency and adequacy. The PDU will thus be an important coordination mechanism for ongoing reforms in various institutions and on various levels and provide for sustainability, as it will address the regulatory body governing and the management systems used in the civil service.

3. Key Development Issues and Challenges

25. In Transparency International's yearly corruption perception survey, Indonesia is ranked 140 out of 159 countries. Corruption is pervasive, especially within state institutions and in their dealings with businesses and citizens. Under the New Order, state institutions neglected good governance and the rule of law, the state managed essential parts of the corporate sector, and vested interests were allowed to rule over common interests. This legacy from the previous authoritarian regime still prevails and has not been challenged until now.

26. In a corrupt state, the legal framework may look just like one in a non-corrupt state. In corrupt states in transition, such as Indonesia, the legal framework is being reformed, new laws are passed, and new institutions necessary for democracy and a market economy are established just as they are in non-corrupt states. But beneath the surface and in spite of reformed legal frameworks and new institutions, in Indonesia the traditional process continues: it is invisible and based on unwritten rules.

4. Government Policy

27. Since 1999, a number of laws have been enacted, including Law 28/1999 on Clean Environment, Law 31/1999 on Eradicating Criminal Acts of Corruption, Law 15/2002 on

Eradicating Money Laundering, and Law 30/2002 on the Establishment of the Commission for Eradication of Corruption (KPK). Important institutional development has occurred, with a range of state auxiliary bodies established with mandates that help fight corruption. These bodies include the Commission for the Audit of the Wealth of State Officials, which was merged with KPK in 2004; National Ombudsman Commission; National Law Commission; and Commission for the Eradication of Money Laundering (PPTAK). The President has set up a task force involving the Attorney General's Office and the National Police to focus on investigation and prosecution of corruption cases. A comprehensive legal and institutional framework for tackling corruption is thus in place. It was not, however, until 2005 that this comprehensive legislation began to be consistently enforced.

28. Government policy has up to now focused on repression: to investigate individual cases and to prosecute the perpetrators in court. Although this has sent important political signals throughout society, corruption eradication is marginal. The Government therefore supports KPK's strategy to focus on prevention and to push for fundamental governance reforms.

5. Institutional Arrangements

29. The administrative structure is fragmented; many areas, including fight against corruption, are handled by several institutions, with overlaps and slow reform pace as results. KPK's mandate overlaps with those of the National Police and Attorney General's Office (AGO). The President recently established a task force consisting of representatives of the national police and the AGO to facilitate coordination between these two. The overall mandate of the task force overlaps not only with that of the police and of the AGO, but also with that of the task force. KPK was set up in response to the very poor performance of the police and prosecutors. While the prosecutors of the AGO bring their cases to the ordinary court system, KPK is bound to bring its prosecution cases to the newly established Anticorruption Court, which is a specialized court with a bench including a majority of ad hoc judges. However, the capacity of the Anticorruption Court is still far from sufficient, not having received any foreign assistance. It is difficult to find and adequately remunerate ad hoc judges. So far, the Anticorruption Court has made five decisions, all severe, and fully applied the Anticorruption Law, earning the court public respect.

30. In addition to KPK, the National Police, Attorney General's Office, and the Anticorruption Court, there are a few specialized anticorruption bodies with specific mandates and thus not overlapping with others. These are the National Ombudsman Commission, the National Law Commission, and the Commission for the Eradication of Money Laundering.

6. Roles of Development Partners

31. Supporting anticorruption efforts is the priority of almost all bilateral donors and multilateral funding institutions, including ADB. Many donors, including ADB, support KPK; others, including ADB, focus on the Ministry of Finance, audit institutions, and procurement. Still other donors are pursuing anticorruption activities in local governments, while several are focusing on the judiciary and the courts. A matrix listing all current donor-supported anticorruption activities is attached to this road map. The matrix is continuously updated at www.kemitraan.or.id/projects.anticorruption.matrixdonor.php.

7. Successes and Lessons Learned by ADB in Fighting Corruption

32. In addition to ADB's many loan-funded activities to strengthen public expenditure management, including audit and fiscal decentralization, as well as to strengthen capacity in regional governments, ADB has implemented several important anticorruption TA projects during the last 5 years.³ All TA projects provide the same lessons: (i) success requires a committed counterpart institution that knows how it wants to use the TA outputs; (ii) the outputs should be instruments to be used by the counterpart institution and not consultant reports in English; only consultants' progress reports should be produced; (iii) domestic consultants should be used to the extent possible, and the use of international consultants should be restricted to provide comparative knowledge and networks that domestic consultants cannot provide; and (iv) the TA should provide for a mix of consultants' input, hardware, and software as well as for capacity building. If a TA only provides for consultant inputs, sustainability is not likely.

8. ADB Operations

33. ADB has a number of ongoing loan-funded activities with an anticorruption and capacity-building focus.⁴ More broadly, program loans under preparation have substantive governance and anticorruption dimensions (Table A6.1). For the duration of the CSP, ADB could consider the following:

- (i) A corruption assessment in line with MTS II needs to be undertaken. Such an assessment should be done in close cooperation with KPK and other donors focusing on similar analyses.
- (ii) Based on the previous good cooperation with KPK and the important results provided under TA 4341 INO Strengthening the Capacity of KPK, another TA to strengthen the capacity of KPK should be considered. The scope should be defined in close cooperation with KPK and other donors.

³ ADB. 1999. *Technical Assistance to Republic of Indonesia for Establishment of an Anticorruption Commission*. Manila. TA 3381-INO, approved on 28 December 1999 for the amount of \$1 million; ADB. 2000. *Technical Assistance to Republic of Indonesia for Improving Public Sector Procurement*. Manila. TA 3471-INO, approved on 21 July 2000 for the amount of \$780,000; ADB. 2000. *Technical Assistance to Republic of Indonesia for Support for the Governments Anticorruption Efforts in Public Relations*. Manila. TA 3608-INO, approved on 21 December 2000 for the amount of \$150,000; ADB. 2001. *Technical Assistance to Republic of Indonesia for Support for the Partnership for Governance Reform in Indonesia*. Manila. TA 3813-INO, approved on 18 December 2001 for the amount of \$750,000; ADB. 2001. *Technical Assistance to Republic of Indonesia for Strengthening Procurement Policies, Legal Framework and Institutions*. Manila. TA 3720-INO, approved on 19 September 2001 for the amount of \$500,000; ADB. 2002. *Technical Assistance to Republic of Indonesia for Strengthening the Capacity of MSRI to Combat Fraud and Corruption*. Manila. TA 3842-INO, approved on 12 March 2002 for the amount of \$625,000; ADB. 2003. *Technical Assistance to Republic of Indonesia for Improvement of the Administration of the Supreme Court*. Manila. TA 4251-INO, approved on 13 December for the amount of \$500,000; and ADB. 2004. *Technical Assistance to Republic of Indonesia for Strengthening the Capacity of the Commission for Eradication of Corruption in Indonesia (KPK)*. Manila. TA 4341-INO, approved on 21 May 2004 for the amount of \$250,000.

⁴ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on Loan to the Republic of Indonesia for Local Government Finance and Governance Reform Program*. Manila. Loan 2193-INO, approved on 3 November 2005 for the amount of \$30 million; ADB. 2004. *Report and Recommendation of the President to the Board of Directors on Loan to the Republic of Indonesia for State Audit Reform Sector Program (Project Loan)*. Manila. Loan 2127-INO, approved on 13 December 2004 for the amount of \$25 million; and ADB. 2002. *Report and Recommendation of the President to the Board of Directors on Loan to the Republic of Indonesia for Sustainable Capacity Building for Decentralization*. Manila. Loan 1964-INO, approved on 10 December 2002 for the amount of \$46 million.

Table A4.1: Governance Dimensions of Program Loans

Policy Intervention	Potential Governance Outcomes
<ul style="list-style-type: none"> Infrastructure Reform Sector Development Program 	<ul style="list-style-type: none"> Transparent bidding for public-private partnership (PPP) projects, under a system that calls for bidding even for unsolicited project proposals Transparent risk-sharing arrangements for PPP projects, based on clear project and sector criteria as well as fiscal prudence Sector and project-level anticorruption measures Level playing field between public and private sector operators in infrastructure provision
<ul style="list-style-type: none"> Financial Sector Reform Program 	<ul style="list-style-type: none"> Strengthening financial and corporate governance in nonbank financial institutions, to ensure that plan commitments to policy holders' are fully met Improving oversight governance Promoting fiscal prudence through social security reform
<ul style="list-style-type: none"> Local Government Finance and Governance Reform SDP 	<ul style="list-style-type: none"> Transparent ex-ante and ex-post public financial management systems in local government, resulting in better public service delivery Enhancing accountability of local governments (to their own citizens as well as to the national Government, which transfers significant fiscal resources) Piloting civil service reforms in selected regions, aimed at strengthening public administration Adopting specific local government anticorruption measures Strengthening internal control systems in local governments
<ul style="list-style-type: none"> Poverty Reduction and Millennium Development Goals Acceleration Program 	<ul style="list-style-type: none"> Efficient public expenditure orientation to ensure that national poverty reduction and MDG acceleration priorities are met across the country, resulting in reduced disparities between the regions Strengthening service delivery and accountability in health, education and other social sectors Establishing minimum norms for service delivery based on sound and transparent costing methodologies
<ul style="list-style-type: none"> Development Policy Support Program 	<ul style="list-style-type: none"> Prudent fiscal management, guided by clear public expenditure orientation and consistent efforts to reduce public debt Strengthening oversight and regulatory governance in the financial sector through the establishment of a transparent financial safety net Improving corporate governance in the banking sector, and strengthen regulatory framework in nonbank financial sector Moving from a system of investment approvals to simple registration, and adopting a transparent negative list. Both could reduce red tape and reduce transaction costs of doing business Improving public financial management through treasury and audit reforms Transparency through the establishment of a Treasury Single Account (TSA) system, with about 30,000 Government's accounts in banks transiting to zero-balance TSA, which in turn will result in an overnight sweep of \$1.2 billion into the TSA

PPP=public-private partnership; SDP=sector development program; TSA=Treasury Single Account
Source: Asian Development Bank

- (iii) A TA to strengthen the capacity of the Anticorruption Court could be considered as the court hampers KPK prosecution of corruption cases.
- (iv) The PDU will most likely focus on reforms of DG tax and DG customs already on their way under the leadership of the minister of finance. The PDU may also focus on reform of other parts of the administration, including the judiciary. It will focus on reform of state-owned enterprises (SOEs). ADB would be well placed to support these reforms.
- (v) ADB could further consider financing retrenchment and early retirement schemes as outcomes of civil service reform efforts under the PDU program.

C. Decentralization: Public Financial and Economic Management

1. Introduction

34. This document describes the key issues and challenges facing Indonesia in decentralization and public financial management, the Government's response to these challenges, and how ADB proposes to work with the Government and other stakeholders to address these challenges in 2006–2009. A road map draws on the Government's National Action Plan for Fiscal Decentralization (NAPFD) and the ongoing substantial work under ADB's various loan and TA projects.

2. Country and Sector Background

35. The “big bang” decentralization of 2001 (on the basis of Law 22/1999) significantly shift in resources and responsibilities from the central and provincial to the district (municipality or *kota* and regencies or *kabupaten*) governments. Under the reforms, district governments were assigned 11 key (obligatory) functions, while provincial governments were given a secondary role.⁵ In line with these expanded responsibilities a major shift of staff resources (about 2.5 million civil servants, of whom about three quarters were teachers or health workers) took place from the central and provincial governments to the districts during the transition period (2000–2001).⁶ Accountability was strengthened as the responsibility for managing local governments was handed over to elected representatives instead of centrally appointed civil servants.

36. A new intergovernmental fiscal framework provided for general allocation grants (DAU), which represent block grants to finance the administrative and other costs associated with newly decentralized functions (rather than the earmarked grants of the past under Law 25/1999). Under the previous centralized system, social and public service indicators of some major resource-producing regions were weak, and to redress this imbalance, these regions were now provided a share of the revenues generated. Law 34/2000 gave local governments the power to levy their own taxes, and was supported by regulations on the type of taxes and service charges permissible and maximum tariffs.⁷

37. ADB has been supporting the Government's decentralization efforts, providing TA to help address some of the issues that have emerged, drawing upon successful decentralization programs in other countries. A two-phase TA on Sustaining Decentralization and Governance Reforms initially focused on helping develop a coherent regulatory environment for fiscal decentralization and in developing a National Action Plan on Fiscal Decentralization (NAPFD) that would define the direction of decentralization policies over the medium term. The key

⁵ Obligatory functions of districts covered public works, health, education and culture, agriculture, communication, industry and trade, capital investment, land, cooperatives and labor affairs. Responsibility for the potentially important revenues source of land administration is currently shared between central and district authorities.

⁶ Overall, local governments were left with significant over-staffing that has restricted their ability to fund new programs. Civil service regulations limit the scope for adjusting staff strength. Moreover, the redistribution of staff to the local governments was highly uneven, with some regions receiving proportionately much larger numbers of staff.

⁷ PP 65/2001 and PP 66/2001 provide detailed implementation guidelines for sub-national taxation. Sub-national governments have recourse to 11 taxes from a “positive list” but they can also levy additional taxes if they meet certain criteria. All new local tax proposals (*peraturan daerah*) are required to be sent to the central government for approval, but the coverage of this review process is less than complete.

government agencies for the sector are the National Development Planning Agency, the Ministry of Home Affairs, and the Ministry of Finance.

3. Key Development Issues and Challenges

38. Decentralization programs have been accompanied by considerable challenges in other developing countries. Some relate only to the management of the transition to a more decentralized system, which in the case of Indonesia have been especially marked given the suddenness of the transition, as sub-national governments experienced an increase in their share of total government budget expenditures from about 15% at the end of the 1990s to about 30% in 2002. Initially (particularly in 2001) provincial and district governments had substantial budget surpluses that partly reflected the disruption to budget planning and implementation caused by the transition. Some of these problems of transition—notably with regard to the overstaffing of sub-national governments—have yet to be fully addressed.

39. More worrying are a number of emerging concerns regarding the impact of decentralization on public service delivery and equity (both intra- and interregional aspects):

- (i) Devolution of functions and responsibilities is often not accompanied by commensurate resources or adequate programs for capacity building to enable local governments to handle their new tasks.
- (ii) As regional variations in the local resource base are substantial, when local governments assume responsibility for significant items of taxation, regional revenue disparities increase.⁸ In the absence of large central revenue equalization transfers, gaps in spending per capita (and public goods and services delivery) widen.

40. Both these problems apply to Indonesia, with the issues of inadequate institutional capacity (shortage of technical staff at the local government level) and the worsening regional disparities, both requiring decisive action. With regard to gaps between the regions, the impact of central transfers such as the Special Allocation Fund (DAK) has not had a significant equalizing effect, while the use of the much larger General Allocation Fund (DAU) has been constrained by “hold harmless” provisions which provide for regional governments to receive at least as much as they obtained in previous years, effectively blocking any redistribution of these resources. The risk is that the ability of the richer regions to invest more in physical and social infrastructure will create the basis for growing economic and social disparities.

41. The studies and analyses under ongoing ADB TA grants, Sustaining Decentralization and Local Governance Reforms and Local Government Financing, show that decentralization appears to have widened regional disparities.⁹ The richer provincial governments, i.e., those

⁸ Local authorities have wide discretion in setting service charges and licensing fees. In 2003, the World Bank estimated that own-source revenues accounted for about one half of provincial government revenues but only about one twelfth of district government revenues. Provincial governments’ relatively large revenues result from the fact that they have been assigned lucrative taxes related to motor vehicles (registration and transfer) of which they retain 70%, the remainder accruing to district governments.

⁹ Available data on fiscal outcomes for 2001-2003 for the 12 provinces included under the Daerah Media Inkubator (DMI), or Regional Media Incubator program was examined under an ongoing TA, together with data on revenue growth, and pattern of expenditures. The DMI is a MOHA-BAKD pilot project initiated in 2005 to improve governance, transparency participation, and accountability in provincial and district governments. Every regional government in this group of 12 provinces is expected to prepare financial reports in full compliance with Government Accounting Standards (Standar Akuntansi Pemerintah—SAP). The regional governments of these 12

with access to revenues from natural resources, have been able to enjoy the best of both worlds in terms of their budgetary finances, benefiting both from the lack of change in the framework for transfers from the center (DAU transfers being maintained at previous levels under hold-harmless provision till 2008), while having access to new sources of local taxation and larger shares of resources sector taxes. This is reflected in the fact that in 2001 the richest 10% of provincial governments had more than six times the revenues of the poorest 10%.

42. These disparities are reflected in the wide variation in per capita spending between the rich Kalimantan Timur and the other provinces. In per capita terms, total expenditures were higher in Kalimantan Timur than in Jawa Barat and Jawa Tengah by a factor of over 11 in 2003. Trends in per capita development spending followed a similar pattern, with even larger gaps emerging. The ratio between the provincial government with the highest spending (Kalimantan Timur) and the lowest rose from about 8 in 2000 (lowest—Jawa Tengah), to 22 by 2003 (lowest per capita spending—Jogjakarta). It can be seen that the sharp widening in the gap between Kalimantan Timur and the other provinces happened following decentralization reforms in 2001.

43. The limitations of the fiscal data reviewed in these studies should be noted. The extent of extra-budgetary operations—reported to remain pervasive in the absence of full implementation of a Treasury Single Account (TSA)—in these provinces is not known. Budgetary accounting systems in Indonesia do not satisfy the key fiscal accountability and transparency requirement of comprehensiveness (coverage of all government financial transactions in gross terms). Until this issue is dealt with, the analysis of financial operations at every tier of government will remain incomplete. Extra-budgetary accounts raise concerns regarding possible misuse of public funds and compromise the integrity of the budgeting process, as expenditures are undertaken without being included in the normal planning, review, and legislative review process that is essential to efficient spending prioritization. The situation is further complicated by significant ownership of state-owned enterprises by local governments (in contrast with the divestiture policies of the central government), and the sometimes complex financial relationships with these agencies.

44. A third issue is the absence of accounting for the use of De-concentration Funds (funds provided to the provincial governments for some transferred functions). Although these funds are actually spent in the provinces by the provincial government administrations, they are not accounted for in the published accounts of the provincial governments, showing up in the national Government accounts only (from which the distribution between provinces is difficult to ascertain). The center continues to spend significant amounts on tasks that are now considered as regional. Such spending, although managed by regional administrations, does not enter the regional budgets.

45. The large amount of de-concentration funds shows that responsibilities have not been substantially devolved to regional governments. During a workshop discussion the regional government officials wanted clarifications on the use of de-concentration funds and how to integrate them in the regional budgets. In this context they noted that central departments retained a large measure of control in the use of these funds, whereas the law clearly stated that these functions had been transferred to the provinces.

provinces are to be provided with special support for training and advisory assistance to develop more effective FMIS in line with the objectives of the project.

4. Key Decentralization Challenges

a. Law, Autonomy, and Functional Assignments

46. There are 33 provinces and 450 district and city governments.¹⁰ The average local governments is not small by international standards, but many new ones lack the human and administrative resources to deliver quality public services. To avoid the creation of unviable regions, the Government should refine the criteria for the creation of new regions, and remove the fiscal incentives for regions to split—including removal of the lump sum per region in the general grant allocation. Regional autonomy encourages expansion of regions, burdening further the state budget without improving the public service delivery.

47. The frequent changes of regulations add to pressures to on an institutional framework already under severe strain as a result of the dramatic functional shifts of the past five years. Regulations are not always clear and there are cases, for example, where implementing regulations and sectoral laws are inconsistent with the core decentralization legislation. In this context, it may be noted that to a much larger extent than other countries, in Indonesia legislation and associated regulations are the driving force behind the introduction of new policies, whereas policy implementation through the budget plays a secondary, supportive role. This may lead to difficulties when budget realities are not taken account of in legislation (an example being the legal requirement to spend 30% of total budgetary resources on education).

48. The management of functions and responsibilities among center, province, and regions is still not clear. Law 32/2004 has not further dwelled upon the responsibilities and mandates for the three levels of the government. The role of the provincial level is especially not well defined in terms of functional and fiscal responsibilities, the restricted assignment of functions does not ensure optimal economies of scale. To enhance efficiency of regional autonomy, the government needs to reinforce the role of the province in the delivery of some services, and in coordinating among the local governments. The optimal size of local governments needs to be discussed in the context of economies of scale in the provision of certain public goods and services.

49. There is a need to balance financing with authority and to ensure that functions and responsibilities match the budget of the local governments. With the issuance of Law 32/2004 and the principle of "money follow functions", there is a need to review the fiscal and administrative relationship between central and local governments through improvements suggested by the law on existing formulas and regulations, and to ensure that public expenditures aim at improving public services and conform to minimum services standards. There needs to be a greater clarity in expenditure assignments among different levels of government.

b. Designing a More Equalizing General Allocation Fund

50. Under Law 33/2004, local government revenues come from (i) own-source revenues, (ii) transfers of DAU, (iii) shared natural resources revenues, and (iv) local borrowing. As only 7% of local revenues on the aggregate level were from own sources in 2005, local governments remain highly dependent on fiscal transfers from the center. Most local governments rely for

¹⁰ A recent ADB mission was informed by the DPOD officials that 92 new local government applications are being evaluated.

over 90% of their revenues on the DAU and natural resource revenue-sharing transfers. The distortions in the main transfer mechanism, the DAU, and the exclusion of most local governments from natural resource revenues have aggravated regional disparities. The DAU does not quite reflect actual expenditure needs (obligatory functions and their minimum service standards). There is a need to formulate guidelines on the minimum service standards that are in line with regional government budgetary realities.

51. Three key constraints undermine the equalizing impact of the DAU: (i) a hold-harmless clause requires that no region can be allocated a lower DAU than the previous year, severely limiting the redistributive function of the grant; (ii) inclusion of the civil service wage bill as a balancing factor that was originally used to compensate the local governments for the large-scale transfer of staff in 2001 is still being included in transfer calculations; and (iii) in calculating fiscal capacities, the formula uses only 75% of a region's revenues from sharing natural resources, which reduces the calculated fiscal capacity of the resource rich regions and acts against equalization.

c. Developing the Special Allocation Fund, Dana Alokasi Khusus (DAK)

52. As a complement to local own revenue and the DAU, the Government needs to develop a system of specific grants to support national priorities such as combating HIV/AIDS. As local government operations are funded by a block grant, line ministries like education and health, have to implement policy and enforce performance standards through administrative regulations such as MSS. These standards are issued without effective links to the budget and without taking local governments' fiscal capacities into account, thus not fully complying with "money follow functions". The small size of the Special Allocation Fund (DAK) (Rp3,000 billion or slightly above one quarter of the DAU) is one of the main causes.

53. An intergovernmental fiscal mechanism could be improved, by which the richer regions, notably those that receive share of the natural resource taxes, no longer receive any DAU. The richer regions should raise resources through a combination of locally raised taxes, shared taxes, and commercial borrowing. The poorer regions should get support through DAU, DAK, and access to well-managed central lending and onlending facilities to enable them to provide services of comparable quality at similar local tax rates throughout Indonesia. The wage bill content of DAU should also be reduced.

d. Strengthening Regional Taxing Power

54. Regional income revenue (PAD) is still small because of limited tax levying authority. It is desirable to increase the share of regional expenditures financed from own regional revenues. The current legislation on regional own revenue allows local governments to issue regional taxes as long as they comply with the principles stated in the law. This system is not working efficiently: the regions have strong incentives to impose improper taxes and levies, and the center does not have the capacity to supervise or to cancel these, thereby raising compliance and administration costs and negatively impacting the business environment in some regions.

55. The way forward is therefore to restrict regional taxes and levies to a limited closed list. The law on Regional Taxes and Charges and related government regulations (65/2001 and 66/2001) require local governments to submit *perdas* (regional regulations) on taxes and charges to Ministry of Finance (MOF) and Ministry of Home Affairs (MOHA) for review and evaluation to ensure that they are consistent with higher laws and regulations. The law requires that *perdas* on taxes and charges be submitted to MOF and MOHA within 15 days after

adoption by the local parliament and that if the national Government has not raised an objection within 30 days of submission, the *perda* shall be regarded as automatically approved. Existing processing procedures and arrangements severely limit the ability of MOF and MOHA to evaluate the many proposed *perdas* within the mandated time frame. About 1,000 new *perdas* are received each year. Usually there is a large backlog and few are evaluated within 30 days. ADB's Local Government Finance and Governance Reform Program will establish a workflow management system to streamline and hasten the *perda* evaluation process.

56. There is a need to evaluate PAD performance and to create incentives and regulations to improve PAD, by taking into account the ratio of PAD to the regional government budget. Regions should be granted additional taxing powers that are more suited for local governments, the prime candidate being the land and building tax. This tax, which is a local tax in most countries, is still a central tax shared with the regions in Indonesia. The Government should give the local governments the authority over rates, while continuing to administer the tax on their behalf.

57. The "Government" could also consider expanding the local tax base at the cost of the provincial tax base. Because most regional government functions are performed by the local government as opposed to the province, these local governments should be the prime receivers of any additional taxing powers. Some of the more attractive regional taxes are assigned to the provinces, like the motor vehicle, vehicle transfer, and motor vehicle fuel taxes, which account for over 90% of provincial revenues. Because of their high tax buoyancies (high rates of increase relative to growth in regional GDP), these taxes represent a large and rapidly growing source of provincial income. The provincial governments are required to share at least 30% of the revenues from motor vehicle and motor vehicle transfer taxes with district and city government in the same province, and 70% of the motor vehicle fuel tax and groundwater and surface water tax.

e. Local Borrowing

58. Both Law 25/1999 and Law 33/2004 permit regional borrowing from domestic and international capital markets. Borrowing is only allowed for revenue generating investments, and loans from abroad must be approved by the center. Law 33/2004 provides for no sovereign guarantee for local government bonds. On the flip side, there is no provision for temporary central takeover of regional authorities that are characterized by financial or administrative mismanagement or unsustainable financial and borrowing policies. Without such sanctions there is a risk that the residents of some jurisdictions may face a sudden drop in basic public services that have been transferred to local authorities.

59. There is a need to develop a transparent and accountable regulatory mechanism for municipal default, which otherwise may lead to moral hazard among local governments. The regional borrowing framework will ensure that regions borrow responsibly, and live within a hard budget constraint. The failure of the regional governments to pay past debts and presence of entities such as PDAM (local government-owned water enterprise) is an obstacle for new investments. Under an ongoing TA, PDAM debt restructuring is being studied in many local governments, and recommendations will be made as how to restructure their debts.

60. The system of borrowing from abroad through the center is yet to be completed, limiting the regions' access to donor funds. Local governments have had little experience with long-term borrowing for capital investment, and virtually no experience with borrowing from private financial institutions outside the national Government. New implementing regulations allow

regional governments to borrow from capital markets. But the mechanism for regional SOEs to borrow is still not clear.

61. The articles in the legislation related to the investment of surpluses by regional authorities lead to a number of concerns. First, it appears that regional authorities have considerable latitude in deciding on whether to undertake commercial investments. This may lead to a situation where the expanding commercial investment by regional governments diverts scarce managerial resources from the core service delivery functions and results in an underperforming public asset. This is in contrast to the policy of the central Government of divestiture and privatization. Second, the provision for secondment of officials to regional government-owned enterprises on non-government salary scales that would appear to create a moral hazard problem. Given these issues, it may be desirable to restrict the investment of surpluses to financial assets that satisfy certain risk and liquidity criteria.

f. Regional Management Capacity

62. Perhaps one of the most difficult problems—particularly as it is the least susceptible to quick solutions—is the weak administrative and managerial capacity at the provincial and local government level, which can only be dealt with through a long term program for developing human resources and building institutional capacity. Much greater resources need to be invested in training and education, particularly in key financial management functions, including budgeting, strategic planning, treasury, accounting, reporting and financial management information systems (FMIS) functions. The number of staff members fully trained in the Government Accounting Standards is reportedly inadequate in many districts and some provinces and there is a need for more training at all levels (including central Government agencies) to understand the operation of the performance budgeting framework and its recent modifications.

63. Another issue has been the difficulty in developing consistent standards of financial accounting across regions (reflecting uneven implementation of MOHA Decree 29/2002), which has complicated the tasks of monitoring and analysis of sub national budget performance by the relevant central agencies. There is a need to strengthen regional and central capacity in management, monitoring, and evaluation of regional finance and fiscal issues. During discussions the regional government officials expressed concerns about the institutional capacity that made it difficult to internalize the complicated regulations set by the center.

g. Civil Service Reforms

64. Some regions face considerable overstaffing as a result of decentralization, while others face shortages. The 2.2 million civil servants decentralized in 2000 were highly unequally distributed across the regions. For instance, Yogyakarta province estimates that 5,000 of its 12,000 staff members are redundant. Despite staff resources being sufficient in terms of numbers, adequate skills are very limited. The civil service law and the decentralization law conflict, with the former defining a centralized civil service, and the latter a decentralized one. Regulations on civil service issued since then seem to lean towards a central, unified civil service accountable to a central civil service board, rather than to the head of region.

65. Developing the capacity of civil servants to discharge regional management functions is absolutely critical and a huge challenge. Civil service reforms need to ensure the mobility of the civil servants across regions, guarantee adequate numbers of civil servants in remote places, and maintain some unifying power in the civil service. Joint training, common standards, open

recruitment, competitive remuneration and a secondment system that would rotate central civil servants in regions on need basis, could be part of a new civil service system.

5. Government Policy and Planning Framework

66. The overall Government policy is enshrined in the Medium-Term National Development Strategy 2004-2009, which aims for regional governments that are effective, efficient, and accountable. The decentralization priorities are captured in the NAPFD framework. The work on the NAPFD involved extensive consultations among the key agencies involved from September 2005 onwards. In February 2006, an ADB-funded National Workshop on the Implementation of the NAPFD was held in Bogor (February 1-2). The meeting was attended by officials of MOHA, MOF, BAPPENAS, and DPOD; officials from regional governments; as well as experts from leading universities. The draft matrix was revised and various issues related to the next phase of implementation and socialization of decentralization initiatives were discussed in a plenary session and in three working groups on (i) functional assignments and capacity development, (ii) regional revenue and expenditure, and (iii) regional financial management. This government document covers all significant aspects of decentralization outlining the activities that need to be undertaken. The discussions reflect the Government's future directions in the following areas:

- (i) **Functional assignments.** After factoring in the inputs of various stakeholders, MOHA is formulating a draft to improve PP25/2000 on the distribution of responsibilities between central and local governments. It will also find the best solution to reduce inconsistencies between regional autonomy laws and sectoral laws.
- (ii) **Matching financing with responsibility.** Action plans will be formulated to (a) conduct a characteristic mapping of the regions according to fiscal needs and capacity as basis for developing equalization and efficiency policies among regions; (b) conduct an assessment to eliminate hold-harmless regulation by end of 2008 by seeking alternative solutions; (c) assess the roles of DAU, DAK, and dana Dekonsentrasi on regional economy.
- (iii) **Strengthening the DPOD.** The Government will recruit experts on financial and regional autonomy and fiscal decentralization for DPOD to (a) conduct an assessment on the implementation of decentralization, regional autonomy, and regional finance and give recommendations to the President on the implementation of regional autonomy and fiscal decentralization; (b) coordinate the implementation of decentralization; (c) evaluate and monitor regional governance; and (d) strengthen coordination between central and regional governments in the implementation of decentralization and regional autonomy.
- (iv) **Minimum services standards (MSS).** A methodology and financing will be formulated to achieve MSS initially for education, health, and basic infrastructure. To help achieving sector targets, indicators will be developed to guarantee minimum services that are to be delivered. The GOI intends to develop instruments to analyze local government planning and budgeting for achieving MSS based on the capacity of regions. A technical standard will be developed to support MSS from each government agency including manuals and standards for expenditures to support implementation of MSS in priority areas. A training module will be developed for the formulation and implementation of MSS in the central agencies and regions. In addition, monitoring and evaluation system instruments for supervision of the implementation of MSS in the province, districts, and cities will be formulated.

- (v) **Regional revenue and fiscal system.** The Government intends to evaluate PAD performance and recommend ways to improve it. An assessment of the delay in distribution of funds will be undertaken and procedures formulated to ensure their timely delivery on a quarterly basis. An adjustment format for DAU will be devised that is more transparent and accountable by revising the calculation of components that are causing regional imbalance. The ideal amount of DAK will be assessed in accordance with national priorities and recommendation will be made to the cabinet to improve transparency and accountability in DAK transfers. A mechanism will be devised to reallocate budget channeled through de-concentration fund into DAK, in accordance with the devolution of functional authorities to the regions.
- (vi) **Regional borrowing.** Government regulations will be drafted on borrowing for regional governments and regional SOEs. Criteria for regional SOE borrowing will be developed identifying types of borrowing that are inconsistent with fiscal prudence. On-lending mechanism for regional SOE will also be formulated. There is also a discussion of drafting a mechanism of withholding DAU to solve the issue of existing regional debt. A government regulation is being prepared on regional government bankruptcy.
- (vii) **Regional financial management.** Guidelines will be prepared on asset management, separation of assets of central, provincial, district/city governments, and asset division for new regions that are being created. The efforts will be strengthened in providing training to implement government accounting standard and regulations on financial regional management.

6. Role of Development Partners

67. TA from multiple donors is supporting the Government's reforms. The International Monetary Fund has provided policy advice and technical assistance for treasury modernization, budget classification and aspects of tax administration. Australian Agency for International Development (AusAID) supports taxpayer services, tax audit, MOF restructuring, debt management, preparation of treasury management regulations and parliamentary capacity-building. The Canadian International Development Agency (CIDA) program focuses on fiscal decentralization, and implementing regulations on budget policy and development, in addition to financing a portion of IMF-led technical assistance to the DG Tax. World Bank's Government Financial Management and Revenue Administration Project I and II support the public financial management reforms. German assistance (GTZ) is supporting public procurement reforms, UNDP's program focuses on parliamentary support and public participation, and United States Agency for International Development (USAID) is providing support for investment and trade, tax Law amendments, and oversight capacity of DPR.

68. The Regional Autonomy Advisory Council (DPOD) serves as a forum for coordination with the Government and among the donor partners. The sector-wide coordination and harmonization of activities in the area of decentralization is being done through the Decentralization Support Facility (DSF), a joint initiative of the World Bank, Netherlands, Department for International Development (United Kingdom), United Nations Development Programme, and Asian Development Bank. Other area- and project-specific opportunities of collaboration among donors present themselves during specific program and project preparations. The World Bank's initiative on performance measurement of local governments in the areas of service delivery, public financial management, fiscal health, and investment climate has been joined by United States Agency for International Development and other donors.

7. Indonesia Capacity and Approach to Managing for Results in the Sector

69. Lack of capacity is a major problem in most local governments, especially in the core functions of planning, policy making, and financial management. Extensive capacity development support is required, for all levels of government, but especially at the district government level and the central agencies in MOHA and MOF that interact with them. Public financial and expenditure management needs to be strengthened on priority basis. As a corollary to developing modern treasury, budget preparation and execution, audit and reporting systems, the introduction of financial management information systems are an imperative. Such systems should be properly sequenced and be able to “talk to” older systems instead of starting afresh. An accompanied capacity building strategy with after care implementation and training should be an integral part of such programs and projects. Since BAPPENAS has placed a moratorium on taking loans for capacity development, ADB needs to make sure that sufficient grant funding is available to sustain capacity development. The Government has adopted a National Framework for Capacity Building, which addresses the issues of regional capacity. ADB needs to work with other donors to finance and implement this framework.

8. Current ADB Operations and Commitments and Potential Lessons

70. The current ADB operations in decentralized financing areas are the following:

- (i) **The Local Government Finance and Governance Reform Program** implements reforms in public expenditure and financial management through development and upgrading of financial management information system in 171 local governments and concerned national agencies of MOHA and MOF. The tightly costed components leave suboptimal resources for after-care implementation and training, this has been partly rectified by merging components and freeing up resources for critical training. The project does not budget anything for developing a change management and communication strategy to socialize the systems among stakeholders, i.e., local governments, MOHA and MOF. As a result, there are continuing huge ownership issues with the project. There is no provision for an independent verification and validation expert to track the project progress and to ensure that the system rolled out conforms to the specifications. The key lesson drawn from the project points to the need for a more careful project preparation to avoid design deficiencies. The complexity and long process of public sector reforms also need to be recognized. A short program loan may not achieve all objectives or bring efficiency and effectiveness in use of public resources and improve public services. These programs should be envisioned over multiple phases.
- (ii) **Effective Institutional Framework for Fiscal Decentralization** is TA that supports the activities of NAPFD actions in the areas of regional autonomy, fiscal decentralization and capacity building.
- (iii) **Support for Local Government Performance Measurement System** is a TA grant that solely focuses on systems development in 40 local governments with scant attention to institutional and capacity building.
- (iv) **Sustaining Decentralization and Local Governance Reforms and Local Government Financing** are the two TA grants supporting work in the areas of intergovernmental fiscal relations, regional autonomy and local government finance. A grant, Support for Regional Government Borrowing System, is closing down.

9. Proposed ADB Activities in the Sector/Theme

71. ADB and other donors working in the sector and thematic area may wish to align their interventions with some of the recommendations of the NAPFD. The following areas may be supported:

- (i) It may be useful to undertake a detailed expenditure review of selected regional governments, with some basic analysis of changes in service standards since decentralization (focusing on a few key indicators in education and health, for example). The data analyses in the provinces of West Java, Lampung, West Sumatera, and Jogjakarta, show that personnel expenditures account for over half of total (routine and development) spending. A large proportion of personnel expenditures are accounted by the wage bill for teachers and health workers, so without a detailed public expenditure review and analysis district wise, it is difficult to come to any definite conclusion about the implications of these patterns for the overall quality of service delivery by district administrations. It may be also be useful to combine such a review with surveys of consumer satisfaction and user assessments of changes since decentralization.
- (ii) Fiscal and budget reforms should be supported at the level of local governments including budget comprehensiveness, elimination of off-budget transactions, moving to a Treasury Single Account, introduction of Medium-Term Expenditure Framework (MTEF), public expenditure tracking surveys (PETS), and pro-poor budgeting. Instruments should be developed for evaluating regional governments, including regional planning and finance. Budget oversight capacity of the provinces needs to be strengthened so that they can provide a meaningful insight into budget formulation and execution processes of the district governments. There is a need for extensive preparatory work to ensure that introduction of the MSS does not compromise regional budget management by imposing fiscally unsustainable spending levels. On the pattern of the Philippines, local government investments in basic services may be enhanced by a system of performance based grants through DAK for improved fiscal equalization among regions. Development and implementation of performance standards for decentralized functions. Procurement reforms should be addressed as part of regional expenditure management.
- (iii) The development of FMIS and information technology systems at the regional government level would integrate budget accounting, implementation and monitoring activities. The integration of accounting and budgeting systems would result in various immediate gains in terms of facilitating budget implementation, cash-flow management and budget planning. For example, the linking of sub-treasuries (intermediate collection points for revenues) at the sub-*district* level would eliminate the problems associated with the current late publication of revenues, thereby speeding up the accounting of local governments' revenue for each period.
- (iv) A diagnostics of capacity-building needs and priorities for local governments should be carried out to assess capacity requirements on demand-driven principles. There is inadequate training of district level, and to a lesser extent, provincial government officials in Government Accounting Standards. Institutional strengthening and training programs in agencies monitoring the decentralization process, notably the DPOD and BAKD, should be carried out, especially to review regional fiscal data and to identify signs of fiscal stress and emerging

- imbalances that may require corrective action. Civil service reforms will be closely aligned with capacity development strategies. Capacity-building programs should be part of the overall strategy with a long-term commitment.
- (v) Regional borrowing should be part of ADB's focus and the allied development of regulatory and procedural mechanisms. Support may be given for improved information on assets and liabilities of regional governments and developing a user-friendly format for its dissemination. Any plans by regional governments to tap local financial markets would necessitate improvements in the quality and coverage of reports on financial data.
 - (vi) Expansion of local governments' own sources of revenues, including reforms of tax administration, is another priority area. A diagnostics on potential regional revenues should be undertaken, in addition to the support for review of the new revenue proposals from sub-national authorities. Both the coverage and timeliness of reviews needs to be strengthened.
 - (vii) There is an urgent need to expand and deepen the socialization of new regulations and legislation as the limited administrative capacity in many local governments makes the interpretation and operationalization of numerous (and sometimes conflicting) regulations a major burden.

Table A4.2: Road map Results Framework

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key opportunities and Constraints	CSP Outcome(s) and Outcome Indicators for Sector	Milestone (Tracking) Indicators	Interventions
More effective, efficient and accountable local governments	Lack of clarity in functional assignments at the three government levels	Improved public service delivery	Strengthened and harmonized framework for planning, budgeting and financial management at the local government level	Proposed: Support for regional public expenditure reviews, fiscal and budget reforms, financial management and information systems, tax administration reforms, capacity building and civil service reforms at local government level
	Non-equalizing general allocation fund DAU	Increase in regional development spending up by 101.	Improved quality and comprehensiveness of local government financial reports	
	Lower ratio of earmarked special allocation fund DAK	Earmarked allocations to local governments doubled to enhance local accountability	Strengthened and rationalized framework for intergovernmental fiscal relations	
	Weak local government taxing power		Strengthened and harmonized framework for regional autonomy	
	Deficient local government borrowing framework			
	Low regional fiscal and management capacities			
	Local civil service reform issues			

CSP = Country Strategy and Program, DAK = Dana Alokasi Khusus (Special Allocation Fund), DAU = Dana Alokasi Umum (General Allocation Fund)

Source: Asian Development Bank

D. Transport Sector

1. Introduction

72. The purpose is to describe the key issues and challenges facing Indonesia in the transport sector, the government's response to these challenges and how ADB proposes to work with government and other stakeholders to address these challenges in the period 2006-2009.

2. Summary Situation Analysis

a. Roads

73. Roads account for the major share of domestic freight and inter-urban passenger land travel in Indonesia, and their coverage and condition are crucial to supporting economic growth and social development. Road density, at 0.19 kilometers (km) per square km or 1.7 km per 1,000 people, is among the lowest in Southeast Asia. While there were substantial investments in road network upgrading and expansion in the 1980s and 1990s, sector expenditures have sharply fallen since the Asian financial crisis, from a peak of around 22% of the overall public budget in mid-1990s to about 10% in recent years. National arterial roads are in a relatively good condition, but almost half of them are congested, pushing up costs for industry and trade, and the network comprises only about 600 km of high-grade toll roads. Provincial roads are also generally well preserved, but district and urban roads are in a poor condition, with upwards of 30% of them unpaved thus restricting all-season access. In terms of spending, there has been a fairly good preservation of national arterial roads but a growing backlog of investments in network improvement and extension. The situation has been reverse at the regional level, with under-spending on preservation having a more negative impact than under-spending in road development. Overall, out of the estimated minimum annual funding requirements of Rp31 trillion (\$3.3 billion), only Rp12 billion (\$1.3 billion) is currently met. This underlines the need for additional domestic and foreign financial resources. The current vehicle acquisition and ownership taxes, and fuel and other operational taxes would cover about 70% of the necessary road maintenance costs. However, proceeds from the vehicle revenues are treated as general tax revenues of the regional governments and not earmarked for road preservation. The potential for financing the maintenance of road assets on a self-sustained basis is thus not used.

b. Ports and Airports

74. Ports and airports are of vital importance and significance to regional cooperation and national integration for Indonesia, an archipelago. In particular, the maritime sector comprising ports and shipping is a key mode for domestic and international trade and passenger travel.¹¹ Sea cargo traffic was hardly affected by the Asian financial crisis, and is projected to grow at 6% per annum for international cargo and 4% per annum for domestic cargo. By contrast, sea passenger traffic did decline after the crisis, and that level is expected to continue in the next few years before a slow growth at 2% per annum is resumed.

¹¹ In 2003, about 600 million tons of cargo and 10 million passengers were accommodated by 725 public and 1,478 private ports, of which 141 were classified as international ports. Twenty-five public ports designated by the Government as strategic ports providing the main gateway for passengers and cargo handle most of the container traffic.

75. There are deficiencies in basic port infrastructure and handling equipment such as draft restrictions in some of the strategic ports that inhibit their ability to receive large vessels and fully participate in regional trade. Inadequate equipment is the main cause of generally low port productivity in terms of average berth occupancy rate, turnaround time and containerization rate. Overall, operational performance and service provision in the sector have not met client expectations and international performance standards. In particular, performance in container terminal operations is considered unsatisfactory by port users. Port tariffs are low, allowing full cost recovery only in larger ports. With the introduction of the International Ship and Port Security Code in July 2004, all international ports in Indonesia have faced the challenge of implementing strict security measures.

76. Air transport also plays a vital role for passengers, and high-value cargo and mail by facilitating mobility, generating economic activity, and providing lifeline access to remote areas, thus helping integrate the islands across the country.¹² The civil aviation industry suffered financial losses after the Asian financial crisis, but has bounced back and is now carrying about 60% more traffic than before the crisis. This has been attributable to lower airfares as a result of competition in air transport and an increasing geographical coverage of air transport services. Long-term projections indicate an annual growth of 5% for the domestic passenger traffic and 6% for the international passenger traffic. While the capacity of the airside facilities is sufficient in the main airports, terminals and aprons are inadequate in some of them. The same is true for many secondary and tertiary airports. Air traffic security is another issue that needs to be addressed. Domestic airport tariffs are kept artificially low and do not allow cost recovery for the services provided to passengers and air carriers. As a result, only major airports with significant international traffic are able to break even in their operations. As with ports, security of strategic airports needs enhancement to deal effectively with security concerns.

77. The current legal framework¹³ defines the various categories of ports and airports, specifies that management of all general ports and all airports is the responsibility of the Government that can delegate it to an SOE, and allows PSP only through cooperation agreement with an SOE. Based on this framework, the Government carved out groups of ports and airports, which were considered commercial (i.e., generating operating profits or having the potential to do so), and allocated these ports and airports for management and development to six SOEs. The SOEs exercise monopoly rights over the ports and airports in their portfolios, managing all aspects of operations, development and PSP. They also act as a regulator in their domain, setting tariffs for the use of port/airport infrastructure and for port/airport services in consultation with Ministry of Transport (MOT). This fragmented approach presents coordination and safety problems.

c. Railways

78. The rail network is limited to Java and Sumatra. Its total length is less than 6,000 km, of which about one quarter is in a non-operating condition. The sector, which accounts for less than 10% of the country's total passenger traffic and less than 1% of total freight traffic, is dominated by the state-owned KAI. Although KAI has faced since 2000 a decreasing demand

¹² In 2003, aircraft movements in Indonesia's 186 airports, 24 of them international, totaled about 500,000, and air traffic passengers – departures and arrivals – about 22 million. Three airports – Soekarno-Hatta in Jakarta, Ngurah Rai in Denpasar, and Juanda in Surabaya – accounted for more than 60% of the passenger traffic.

¹³ Maritime Law 21/1992, Government Regulation 69/2001, and the implementing Ministerial Decrees 53, 54, 55 and 56/2002 for ports; and Aviation Law 15/1992, Government Regulation 70/2001, and the implementing Ministerial Decrees 44,45 and 48/2002 for airports.

and under-utilization of track and rolling stock due to low competitiveness of rail vis-à-vis road, air and ferry services, it is still reporting small profits. However, its real profitability is difficult to assess, as KAI operates within a complex web of subsidies, PSO arrangements, contracts with other SOEs, and caps on its passenger fares, and lacks reliable data for costing and cost allocation.

79. Based on the Law 13/1992 on Railways and the related implementing regulations, in particular the Government Regulation 69/1998 on Train Traffic and Transportation, the Government through MOT is responsible for sector planning, policy making, regulation, and provision of the basic infrastructure such as rail tracks and signaling, while KAI is in charge of operating and maintaining this infrastructure, and providing the rail services. PSP is allowed through a cooperation agreement with KAI, but none has materialized so far.

3. Key Development Issues and Challenges

a. Inadequate Investment in Infrastructure

80. Overall, the available road network is inadequate, but in relative terms the district/rural road network is vastly inadequate and also in worse condition in terms of quality. While the national road network is also inadequate, the quality of new or maintained roads is not bad. The problems of the adequacy and quality of infrastructure result in congestion, delays, high operating costs and poor safety. The main problem is lack of regular maintenance of the road network. Other causes include overloading of vehicles, demand/capacity imbalance, lack of funding, lack of productivity and management and weak and uncoordinated institutions. The 1997 Asian financial crisis caused disruption to construction of the toll road network. There are major gaps, and additions are still required. The poor level of road safety, which is a major problem in road transport, is caused primarily by factors such as speed, driver capability, poor vehicle condition, poor road design, overloading and excess driver hours. High accident rates, and overloading, however, occur because of inadequate enforcement of regulations, and increasingly where local governments see fines as a revenue source rather than a means to eliminate damaging practices.

81. The current budget for national roads is about \$400 million/year. The Government has set a target to develop 1,500 km of expressway roads in Java and Sumatra in the next 10 to 15 years that will require a budget of about \$1 billion/year. Should the Government increase road budget by 25%, the total budget required would be roughly about \$1.5 billion/year, to be shared by the Government and the private sector.

82. Ports are generally inefficient, imposing additional time and costs on domestic cargoes and exports. Private sector finance and containerization have been slow to develop, especially outside of the main ports on Java. The introduction of technology and the facilitation of inter-modal transfers have also been slow. While the main airports function well, there are issues about air safety security management and funding resources for development of the medium-sized and small airports, especially those in remote areas. Increased transport demand due to sector deregulation and low cost airlines is putting pressure on capacity at medium-sized airports. For the revenue-generating subsectors, such as ports and airports, investment needs have also been difficult to meet because of the Government's budget constraints, low tariffs, lack of private sector investment, and low demand, especially outside Java. Air transport safety and security also deserve attention given the rapidly expanding commercial fleet, the absence of a unified air traffic control, and the overall security concerns in the region.

83. Under the current level of investment and operation, the yearly budget of the port sector (Government and PELINDOs) is estimated roughly at about Rp5 trillion or \$500 million. Meanwhile, the Government estimated new investments in the port sector (public and private) requiring a budget of about \$700 million in the next 5 years or about \$140 million/year.¹⁴ The Government financing capacity (without foreign loans) in 2004 for the port sector was roughly estimated at \$20 million¹⁵ showing a big financing gap between the required budget and Government's financing capacity for the port sector.

84. The Government estimated that new investments in the airport sector (public and private) require a budget of about \$830 million in the next 5 years or about \$166 million/year.¹⁶ This level of investment is approximately the same as that estimated under a 2004 JICA study.¹⁷ Meanwhile, the Government financing capacity (without external sources) in 2004 for the airport sector is roughly estimated at \$20 million,¹⁸ showing a tremendous financing gap.

b. Private Sector Participation and Regulatory Framework

85. A primary problem in the transport sector is that while the insufficient size of government investment in the sector is recognized, full private sector participation (PSP) in the sector has been limited due to restrictions set out in the existing regulations. This has led to poor service and poor financial performance in port and airport operations.

86. The new Road Law 38/2004 and the subsequent Government Regulation 15/2005 on Toll Roads have reformed the legal framework and paved the way for greater PSP.¹⁹ They have unbundled the sector by splitting off the regulatory functions from its main SOE, Jasa Marga; calling for the establishment of a new regulatory body; ending Jasa Marga's monopoly on toll road development; and allowing fully private investors to bid for new build-operate-transfer or concession projects in competition with Jasa Marga. In August 2005, a decree was issued by the Ministry of Public Works (MPW),²⁰ which enables the toll road tariffs to be set on the basis of a bidding process. At the same time, tariffs for existing toll roads were increased by 15-50% to ensure financial sustainability of their operation. To complete the legal framework, MPW has drafted a Government Regulation on Roads and Bridges. As stipulated by the new legal framework, the Indonesian Toll Road Authority (BPJT) which reports to the Minister of Public Works, was established in October 2005. Its responsibilities include developing business plans and feasibility studies for toll road projects; conducting bidding, facilitating land acquisition, and recommending tariffs for such projects; and supervising implementation of toll road concessions.

¹⁴ Transport Infrastructure Development Program 2005-2009 of Ministry of Transportation. The Study on the Port Development Strategy conducted by JICA (1999) estimated annual budget required for port development of about \$100 million annually for the next 10 years.

¹⁵ Assuming that the port sector budget is about 40% of the total 2004 sea transport sector of approximately \$50 million (2005 MOT Work Plan).

¹⁶ Transport Infrastructure Development Program 2005-2009 of Ministry of Transportation. The Study on the Port Development Strategy conducted by JICA (1999) estimated annual budget required for port development of about \$100 million annually for the next 10 years.

¹⁷ The Master Plan Study on the Strategic Policy of the Air Transport Sector in the Republic of Indonesia. JICA. 2004.

¹⁸ Assuming that the airport sector budget is about 40% of the total 2004 air transport sector of about \$50 million (2005 MOT Work Plan).

¹⁹ To date, the private sector has been involved in the development of only 24% of the 600-km toll road network.

²⁰ 374/KPTS/M/2005.

87. Both ports and airports have a good potential for PSP, but its use leaves much to be desired because of the lack of a level playing field. In the port sector, three of the four PELINDOs (State Port Management Corporation) have formed joint ventures with private operators. These arrangements with the PELINDOs acting as both the landlord²¹ and operator, deter further PSP, as potential investors in new port terminals will not expect fair treatment from a landlord with a financial stake in an existing operator. PSP in the airport sector has been very limited to date, and has generally taken the form of subcontracts for selected landside services. Another impediment to PSP has been the uncertainty caused by regional autonomy legislation, which has conferred authority over public works, including ports and airports, to local governments.²² This has created a potential for conflicts with the PELINDOs and Angkasa Puras (State Airport Management Corporation) .

c. Institutional Structure

88. The government agencies playing key roles in the transport sector include the Ministry of Finance, Ministry of State-Owned Enterprises, MOT, and National Development Planning Agency (BAPPENAS); the provincial, district, and city governments share regional transport sector responsibilities. MOT consists of three directorate generals dealing with transport. Institutional problems in transport include lack of sector coordination both internally and with other sectors, weak capacity and institutions, and lack of appropriate laws and regulations. Overcoming or mitigating institutional problems would make a significant contribution to solving the problems of the sector. The overlap in responsibilities for development and maintenance of road assets between Ministry of Public Works and Ministry of Transportation needs to be addressed. The other issue is the improper mobilization of the institutional capacity, which has been strengthened through several donor-assisted projects over past decades, but appears to be eroding.

89. The impact of decentralization on transport infrastructure provision and services as well as institutions has not been fully assessed yet. As part of the fiscal and administrative decentralization process, made effective in 2001, Law 32/2004 (revised 22/1999) has transferred most Government responsibilities to the regions, with regencies and cities as the main focal points. Law 33/2004 (revised 25/1999) specifies how the new regional responsibilities are to be financed. For instance, motor vehicle fuel taxes are collected directly by provinces or kabupaten for their own purposes. Slow use of funding of the sector whether through foreign loans or grants, or through the private sector is a problem caused by institutional blockages. In particular, in the absence of a clear funding policy, financial arrangements for infrastructure development have to be worked out on a case-by-case basis, with protracted interagency discussions and delayed decision-making process.

90. The lack of funding contributes to many of the sector problems and is linked to institutional aspects. The financial needs of the sector are huge, and to mobilize sufficient resources would require support from sector institutions, institutional and regulatory changes, as well as political support. In addition, a sustainable funding mechanism should be established for pioneer transport services in remote areas. Deeper involvement of the private sector through

²¹ Landlord functions in ports and airports include berth/terminal assignment, allocation of shed and warehouse space, control of all vehicles that enter and leave the ports/airports, cleaning and maintenance of infrastructure, and collection of fees.

²² Law on Regional Autonomy 22/1999, Government Regulation 25/2000, and the revised Law on Regional Autonomy 32/2004. Government Regulations 69 and 70/2001 issued to clarify the responsibilities of local governments.

private sector operations and PSP is impeded by low tariffs and profitability, and various institutional constraints such as weak bidding procedures.

91. Weak planning of the transport sector and its various inadequacies also result in the limited attention given to environmental and social issues, especially gender, health, and human trafficking. Adequate laws and regulations should be enacted to address these issues as part of the development objectives, more specifically in the remote areas. Improving the environment/mitigating impacts and poverty targeting appear are very limited concerns of DGH and MOT although there are important environmental guidelines and legislation as well as affordability being an important objective.

92. Institutional capacity in the road sector is still weak in some aspects. While asset management capacity has been built up at the national level, development planning needs strengthening. Regional agencies vary considerably in capacity and performance, and inter-agency coordination is weak. Heavy vehicle overloading is prevalent, significantly increasing road preservation costs, and road safety is poor. The implementation of road works is often expensive and of low quality, and collusion among contractors is a problem. The business practices and performance of the national agencies and the construction industry need to be improved, and capacity of the regional agencies built up. Regulatory enforcement to reduce vehicle overloading needs to be strengthened, and a comprehensive road safety program implemented. MPW, together with the MOT and with assistance from the World Bank, is preparing two initiatives in these areas, namely, a pilot road safety program in Semarang in the second half of 2006 and pilot testing of performance-based contracts for road maintenance, including vehicle load control, in Central Java in early 2007.

93. DGST formulates and implements policy and technical standards in the sea transport subsector, including port development. However, its responsibilities do not include managing ferry shipping and ports, which fall under the responsibility of the Directorate General of Land Transportation. While technically, port development under the PELINDOs must follow MOT's technical guidance, the PELINDOs are also under the supervision of the Ministry of State-Owned Enterprises. MOT's role in port operation is through the seaport administration offices (ADPELs) established in all public ports. In some cases, the PELINDOs and regional governments are jointly developing ports within the area of jurisdiction of the regional government.²³ The PELINDO as a port operator provides and manages (i) ship-handling services, such as pilotage, towage, berthage, and anchorage; (ii) cargo-handling services; and (iii) other services, including rental of land, warehouses, and office space. The ADPEL supervises sea traffic, port security, and safety in territorial waters and in ports.

94. The legal and regulatory framework for ports and airports needs to be revised to end the monopolies of the six SOEs, and their multiple role of a landlord, regulator, contracting authority for the provision of port/airport services, and operator. In addition, the creation of a separate provider of air traffic services should be considered. Significant progress has been made in revising the legal and regulatory framework. The Presidential Decree 5/2005 on Empowering Domestic Shipping Industry promotes the separation of regulatory and operational functions in ports, and allows more than one terminal operator to enhance competition. MOT has completed the drafting of new laws for sea transport and aviation. It is important that the new laws, including the subsequent implementing regulations, provide for such sector restructuring. In particular, the legal framework should allow the establishment of true landlord port and airport

²³ The governments of Bontang, Central Sulawesi, Gorontalo, and Manokwari.

structures where the landlords have no direct financial stake in any service providers, and should clarify the roles and responsibilities of local governments.

4. Government Policy and Planning Framework

95. The 2004–2009 Government midterm development plan places high priority on the development of infrastructure within the overarching objectives of creating peace and security, creating democracy and fairness, and improving prosperity. Road development policy is prioritized on increasing road capacity and quality to more developed regions by strengthening island-based main national road corridors and providing better access to less developed regions, including remote and border areas. The development of these national corridors is part of the Government's commitment to the ASEAN regional cooperation program, which requires implementation of priority infrastructure projects at national level. Improving integration and connectivity, developing land transport and trade corridors linking Brunei Darussalam, Indonesia, and Malaysia are ASEAN milestone objectives.

96. MOT developed the 2005–2009 transport strategic plan, and DGLC periodically updates its policy statement and action plan (PSAP) for roads, traffic, and transport. The first PSAP was issued in 1989; the most recent draft covers 2001–2005. The ongoing ADB financed Road Rehabilitation (Sector) Project (RRSP)²⁴—includes a component to help DGLC monitor the PSAP's progress and implement policies related to user charges, cost recovery, road maintenance funding, vehicle overloading, road safety, and private sector participation. This component helps amend road and road transport regulations to encourage competition in road transport services, and strengthen road management and development planning.

97. The Government has set a plan to develop strategic ports during 2005–2009, including Balikpapan, Bojonegoro, Dumai, East Ancol (Jakarta), Jayapura, Muara Sabak, Semarang, and Teluklamong (Surabaya).²⁵ Moreover, the Government has made some efforts to improve port security, particularly in selected major ports with the assistance of the United States Trade and Development Agency and the Japan International Cooperation Agency. Complementing the physical investment plan, the Government has prepared port subsector policy and regulatory reform that will be followed by actions basically comprising three stages

5. Role of Development Partners

98. Indonesia had received about \$7.6 billion in foreign assistance for road development from 1984 to 2003. Of this, 33% came from the World Bank and 33% from the Japan Bank for International Cooperation (JBIC). ADB's contribution was about 17% and bilateral funding agencies from countries such as Australia, Austria, Germany, Kuwait, Saudi Arabia, and the United States provided the remaining 17%. ADB has also provided grants totaling \$4.3 million. The World Bank has been so far focusing on road sector (including kabupaten road and village road) and railway sector, while JBIC has been involved in various transport sectors including road, rail, port, airport, shipping, and ferry services; and currently, has started looking for opportunity to support urban transport.

²⁴ ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the Road Rehabilitation Sector Project*. Manila. Loan 1798-INO, approved on December 2000 for the amount of \$190 million.

²⁵ The MOT Strategic Plan (2005–2009) indicates the source of financing including government budget, state-owned enterprise financing, and private sector financing required to implement the investment plan.

99. JBIC has financed the development of Dumai Port, Kupang Port, and a number of small ports in eastern Indonesia. In addition, the Japan International Cooperation Agency has been very active providing TA to the Government in various transport sub-sectors, including ferry and sea transport sub-sectors. The World Bank has no involvement in the port sector. JBIC has been funding the upgrading of international and regional airports (Bali and Balikpapan airports have been completed; and Surabaya, Palembang, and Padang airports are ongoing). Bilateral donors such as Australia, Japan, Germany, France, Sweden, and the United States provided significant assistance for airport upgrading, equipment supply, and institutional strengthening. The World Bank has no involvement in the airport sector.

100. Indonesia's institutional capacity in the transport sector is weak in some aspects (paras. 16–22). This extends to the capacity for managing for results, and advisory technical assistance will be necessary to improve the capacity and approach.

6. Successes and Lessons Learned by ADB in the Sector

101. ADB has assisted the transport sector since 1975. ADB's total lending to the road sector amounts to \$1.57 billion for 15 projects, 14 of which have been completed. ADB has also provided grants totaling \$4.3 million. Project completion reports have been prepared for 14 ADB-financed road projects, with all rated projects considered successful except one partly successful. Performance audit reports have been prepared for nine projects, all rated successful. The reports identified the following key lessons: (i) in the short term, projects should focus on periodic maintenance and rehabilitation; (ii) simplified design procedures used by DGH to prepare subprojects on a network basis should be replaced with detailed design methods; (iii) economic evaluation should be more thorough, especially traffic growth projections; (iv) greater attention should be paid to drainage structures; (v) periodic maintenance should not compensate for delayed or poor routine maintenance; and (vi) the capacity of the executing agency and its relationship with the implementing agency are crucial to project success. Another lesson is that capacity and institution building should be implemented regularly to avoid skill loss as a result of staff retirement or transfer. Some projects have been delayed by lack or late release of counterpart funds, and by land acquisition and resettlement problems. Resettlement issues have been minimized under the ongoing RRSP, which, however, suffered other delays. Fraudulent practices and corruption, especially in procurement, were also perceived to have led to poor quality of work.

102. ADB has provided seven loans, for a total of \$203.7 million, to finance port subsector development in Indonesia. These projects in the port subsector were effective and implemented satisfactorily. They were implemented without major cost overruns, although some delays in completion were experienced. In general, problems encountered were mainly delays in lengthy internal procedures, particularly for selecting consultants and contractors and approving contracts. Projects need to be complemented with appropriate policy, and work and institutional improvements to improve port efficiency and sustainability. To avoid delays in project preparation, early preparation of detailed engineering design would help the Government expedite project implementation.

7. Current ADB Operations and Commitments

103. ADB has two ongoing road projects, the Road Rehabilitation (Sector) Project (RRSP)²⁶ and the Road Rehabilitation-2 Project.²⁷

8. Proposed ADB Role in the Sector

104. ADB's objective for the transport sector is to improve Indonesia's transport network by increasing the quantity and quality of infrastructure and operations. ADB will address the constraints of inadequate investment in the transport sector, low levels of private sector participation, and the inefficient institutional structure and inadequate planning. ADB will directly address the inadequate investment in the transport sector by implementing projects to increase the capacity of selected roads and ports that play important roles in domestic and regional trade. ADB will address the low levels of private sector participation in two ways. First, reforms enacted under the Infrastructure Reform Program will greatly improve the attractiveness of the transport sector to private investors. Second, ADB will directly participate in private-sector-financed transport projects, such as toll roads. ADB will also improve the inefficient institutional structure and inadequate planning through reforms enacted under the Infrastructure Reform Program, policy dialogue under project loans, and advisory technical assistance grants to assist in the planning and implementation of further reforms.

9. Proposed Sector Outcomes and Outputs to be Supported by ADB

105. The transport sector development outcomes of the CSP include increased capacity of the transport system, increased private-sector participation in transport sector, and an improved institutional structure and planning for the sector (Table A6.1). ADB will assist in increasing capacity of the road and port subsectors of the transport system. The increased capacity will be measured by indicators such as the km of good quality roads and port and cargo capacity. Increased private-sector participation in transport sector will be measured by indicators such as the number of toll road, port, and airport projects involving private sector participation. The improved institutional structure for the transport sector will be measured by measures enacted and/or implemented to improve the structure for the road, sea, and air transport subsectors.

10. Proposed ADB Activities

106. ADB's program for the transport sector in 2006–2009 includes five public sector loans for the road, and port subsectors as well as participation in private-sector transport projects. In 2006, the ADB program includes the Infrastructure Reform Program and the Interisland Ports Project. The Infrastructure Reform Program is composed of three program loans of \$300 million each in 2006, 2008, and 2010. The reforms enacted as part of the Infrastructure Reform Program, which addresses other infrastructure sectors in addition to transport, will facilitate future development of the sector, including private sector participation. The Regional Road Development Project will be a Multitranches Financing Facility, with the first tranche of \$100

²⁶ ADB. 2000. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the Road Rehabilitation Sector Project*. Manila, Loan 1798-INO, approved in December 2000, for the amount of \$190 million.

²⁷ ADB. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Republic of Indonesia for the Road Rehabilitation-2 Project*. Manila, Loan 2184-INO, approved in September 2005 for the amount of \$151 million.

million proposed for in 2009. ADB will also participate in private-sector-financed projects in the transport sector, particularly for toll roads, ports, and airports.

Table A4.3: Sector Road map Results Framework

Medium-Term Development Goals for Sector	CSP Outcomes			
Sector Outcomes for Country ^a	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators for Sector	Milestone (Tracking) Indicators	Interventions
Improved transport system in quantity and quality of infrastructure	Inadequate investment	Increased capacity of transport system	Increase in km of good quality roads	Regional Road Development Project
			Increase in port capacity (berth length m) and port cargo capacity (yard area m)	Interisland Ports Project; Port Development Project
			Number of toll roads with PSP	Infrastructure Reform Program
	Low levels of private sector participation (PSP)	Improved regulatory framework for private-sector participation Increased private-sector participation in transport sector	Number of port projects with PSP Number of airport projects with PSP	ADB participation in private-sector toll road, port, and airport projects Infrastructure Reform Program
	Inefficient institutional structure and inadequate planning for the transport sector	Improved institutional efficiency and planning	Undertake measures to improve the institutional structure and planning for the road, sea, and air transport subsectors.]	Policy dialogue under project loans Advisory technical assistance grants

^a Only outcomes relevant to ADB's road map and CSP are listed in this results framework
Source: Asian Development Bank

E. Energy Sector

1. Introduction

107. The purpose is to describe the key issues and challenges facing Indonesia in the energy sector, the government's response to these challenges and how ADB proposes to work with government and other stakeholders to address these challenges in the period 2006-2009.

2. Summary Situation Analysis

108. Indonesia is well endowed with energy resources and has significant reserves of oil, natural gas and coal (Table A6.4). With proven gas reserves of 2.56 trillion cubic meters (m³), Indonesia has the 13th largest in the world and the largest reserves in Asia and the Pacific. The proven gas reserves are equivalent to three times Indonesia's oil reserves. Proven coal reserves are expected to last 38 years at current rates of extraction. Oil reserves are gradually declining due to inadequate investments in exploration. The proved oil reserve position in Indonesia has remained at about 5 billion barrels but with a declining trend since 1990. With production at approximately 1 million barrels per day in 2005, proven reserves would last about 12 years.

Table A4.4: Energy Reserves (2004)

Fuel		Reserves	Production Ratio
Oil	Billion barrels	4.72	11.5
Gas	Trillion cubic meters	2.56	34.9
Coal	Million tons	4,968.00	38.0
- Anthracite	Million tons	740.00	
- Sub-bituminous and Lignite	Million tons	4228.00	

Source: BP Energy Statistics 2005.

109. Indonesia has the lowest electrification ratio in the region (Table A6.5). Despite an average electrification of 1 million households every year since 1974, the electrification ratio was only 57% in 2004. 90 million people are without access to electricity and two-thirds of these are outside the main Java-Bali grid where the cost of electricity supply is high.

Table A4.5: Electrification Ratios Across Countries (%)

Country	1994	2003
Viet Nam	15	83.5
Philippines	87	82.0
Indonesia	39	55.0
China	92	96.0
Thailand	87	95.0

Source: World Bank, 2005.

110. Energy consumption in Indonesia is dominated by oil and gas, which account for 80% of the total energy (Table A6.6). Since 2000, the domestic oil production has declined, due to natural maturation of producing fields combined with a slower reserve replacement rate. The consumption of oil and oil products has been increasing steadily. As a result in 2004, Indonesian oil production and consumption was just about even, and in 2005 Indonesia became a net importer of oil. The share of natural gas in the domestic energy mix has remained below

30% due to an inadequate gas supply infrastructure, and higher and more attractive international prices.

Table A4.6: Share of Different Energy Sources

% Share	1990	1995	2000	2001	2002	2003
Crude Oil and Oil Fuels	60.13	53.36	57.79	53.34	53.35	54.28
Coal	5.60	6.53	10.18	13.80	14.32	14.25
Natural Gas, LPG, and LNG	29.44	44.62	27.64	27.98	28.05	26.46
Hydropower	4.38	3.82	3.22	3.48	2.87	3.58
Geothermal	0.44	0.61	1.18	1.40	1.40	1.44

LNG=Liquified Natural Gas. LPG=Liquified Petroleum Gas

Source: Government of Indonesia.

111. Energy has historically contributed significantly to Indonesia's GDP and export earnings. Abundant energy resources allowed the Government to subsidize domestic fuel prices in the past. Fuel subsidies ranged from \$4-7 billion per year since the financial crisis. In 2005 with the sharp escalation in world oil prices, and with the country becoming a net oil importer, fuel subsidies would have increased to \$12 billion. This forced the Government to increase oil prices by over 100%.

112. The Medium-Term Development Plan (RPJM) has set macroeconomic targets for 2005-2009 to accelerate GDP growth from 4.5% to 7.6% (with an annual average of 6.6%), increase the investment/GDP ratio from 20.5% to 28.4%, reduce unemployment from 9.7% to 5.1%, and halve the poverty rate from 16.6% to 8.2%. Reliable and efficient energy supply is an essential input to achieve these targets. The government has estimated that \$145 billion are required for investment in infrastructure by 2009, with only 25% coming from the government budget and at least \$80 billion from the private sector. This requires developing an investment climate that is conducive to private sector participation.

113. PLN's current installed capacity of about 21,800 MW and the capacity of about 3,400 mega watt contracted from independent power producers (IPPs) are insufficient to meet peak demand outside the main grid of Java-Bali and leave an inadequate margin within it. There are a large number of captive, mostly diesel, power plants,²⁹ but their operation has become too costly following the fuel subsidy removal. Power demand is projected to grow at an annual rate of 6.6% through 2013.³⁰ To meet the forecast demand, 1,000-2,000 MW of additional generating capacity needs to be commissioned annually. PLN has a sound generation expansion program, consisting of three projects totaling 2,660 MW that will be commissioned in 2006-2007³¹ and eight projects totaling 3,670 MW that are being put up for bidding in a staged manner.³² The fact

²⁹ Approximately 10,000 companies maintain their own sources of power, mostly to mitigate the risks of grid supply outages. The combined installed capacity of these captive power plants is estimated at 13,000-15,000 MW, or roughly half of PLN's total capacity.

³⁰ Directorate General of Electricity and Energy Utilization. 2004. *National Electricity Master Plan 2004*. Jakarta. PLN's latest power development plan for 2006-2015 is based on a higher demand growth of 8.5% per annum.

³¹ Cilacap in Central Java (600 MW, coal); Cilegon in West Java (740 MW, natural gas, implemented by PLN with JBIC financing); and Tanjung Jati B in Central Java (1,320 MW, coal).

³² Cirebon in West Java (600 MW, coal, bidding underway); Central Java (1,200 MW, coal); Pasuruan in East Java (500 MW, natural gas); Paiton 3 and 4 in East Java (800 MW, coal); Bali (200 MW, coal); Sibolga in North Sumatra (200 MW, coal); Amurang in North Sulawesi (50 MW, coal); and East Kalimantan (120 MW, natural gas).

that all these projects except Cilegon are to be executed on an independent power producer (IPP) basis highlights the importance of private sector participation.

Table A4.7: Power Demand (2004–2020)

Item	2005	2010	2015	2020
Electricity Sales (GWh)	105,828.00	167,382.00	277,037.00	322,278.00
Installed Capacity (MW)	25,852.00	41,873.00	64,694.00	73,415.00
Number of Consumers (million)	36.12	47.07	58.85	n/a
Per Capita Consumption (kWh)	483.84	731.48	1,160.54	n/a

GWh = gigawatt hours, kWh = kilowatt hours, MW = megawatt

Source: PLN, 2005

Table A4.8: PLN Operating Performance

Item	2000	2001	2002	2003	2004
Generator Own Use (%)	4.05	4.19	4.20	4.35	5.72
Transmission Losses (%)	2.56	2.38	2.59	2.46	2.33
Distribution Losses (%)	9.08	11.14	13.87	14.41	8.96
Total Losses (%)	11.65	13.52	16.45	16.88	11.29
SAIFI (times/customer/year)	13.90	13.24	14.35	10.90	9.43
SAIDI (hours/customer/year)	18.10	15.12	14.17	12.51	11.78

SAIDI = system average interruption duration index (hours/customer), SAIFI = system average interruption frequency index (times/customer).

Source: PLN Statistic 2004

114. In 2006, the Government announced the crash program of developing 10,000 MW of coal fired capacity by 2009. This would displace more expensive oil based generation and reduce the overall cost of electricity generation.

3. Key Development Issues and Challenges

115. The Government has an urgent commitment to meet the rising electricity demand and improve the deteriorating electricity infrastructure. Indonesia's power sector has the lowest electrification ratio in the region, poor profitability, is heavily dependent on oil-based fuel and lacking new investment. The Government has committed to increase the electrification ratio to 95% by 2025. With required installed demand estimated at 42 GW in 2010, the Government estimated the required investment of \$19 billion–\$25 billion in 2004–2012. The Government is expecting the private sector to contribute \$2.6 billion–\$7.2 billion, mostly for power generation. This magnitude of investments estimated for the energy sector requires the active participation of the private sector, for which the right enabling environment needs to be created.

116. More than 87% of the recoverable oil reserves have been exhausted and 90% of the oil comes from oil fields with declining rates of production. New investments in the exploration and production, and development of infrastructure for oil and gas are required. Thus far oil companies are waiting for clarity in the implementation rules and regulations for the Oil and Gas Law (no. 22/2001), and an enunciation of incentives for investments in the sector.

117. Indonesia has significant reserves of coal bed methane (CBM) estimated at 400 Tcf with at least 10% that can be economically extracted, yet there is no CBM project in operation. Currently CBM is under the jurisdiction of the Directorate General of Oil and Gas, explaining the lack of interest by the coal companies in exploiting this important resource. A policy framework and regulation need to be developed for CBM that take into account the role of the coal

company, the role of the local government as the permit issuer of coal mines development, accounting guidelines to properly allocate costs to CBM and coal, profit sharing between the operating company, the local and the central government.

118. Other than on the larger islands in Indonesia, power grids are small and economies of scale are not available. In regions with low population density and low average consumption per capita, cost of service are even higher. In such situations, the use of decentralized renewable energy sources, such as mini hydropower and biomass based generation, become attractive alternatives and opens opportunities to benefit from the clean development mechanism (CDM) established under the Kyoto Protocol. CDM can provide significant support to cleaner and more efficient utilization of energy through access to additional financing resources. Therefore, in addition to its conventional energy sources, Indonesia needs to develop its renewable energy (for example, wind, geothermal) and CBM resources.

4. Government Policy and Planning Framework

119. The Government has developed the Energy Blueprint for 2005-2025, appropriately recognizing the present energy scenario with a high share of oil in the energy mix and the new dependence on oil imports, limited community access to energy, the non-optimal operation of the energy sector because of subsidized energy prices and lack of adequate infrastructure.

120. The Energy Blueprint sets targets for the sector that include achieving the following:

- (i) an electrification ratio of 95% by 2025;
- (ii) national energy supply security through an energy elasticity of less than 1, an optimal energy mix that includes reducing the share of oil to 26.2%, increasing the share of natural gas to 30.6%, and increasing the share of coal to 32.7% by 2025;
- (iii) a robust energy infrastructure that would include oil and gas pipeline networks, refineries and transit terminals, LNG terminals, coal transportation infrastructure, and electricity transmission networks;
- (iv) rationalized energy prices; and
- (v) implementation of energy efficiency measures.

121. The draft energy law which is based on the energy blueprint focuses on optimal use of energy through proper planning, efficient use, diversification of energy sources, reduced reliance on use of fossil energy, and the utilization of domestic energy resources to benefit the national economy. The law is expected to be passed by the end of 2006 or early 2007. The country's energy policy and strategy should aim for optimal use of domestic energy resources, increasing the value added of energy resources while minimizing its environmental impacts, supplying energy to underprivileged and less developed areas, and developing national capabilities and capacity to achieve self-sufficiency through increased production capacity of indigenous energy supplies, optimizing energy production, and conserving energy resources. On the use side, it would emphasize on improving efficiency of energy use, and diversification of energy sources. Prudent energy pricing, with effective targeting of subsidies for the poor, is required to achieve these objectives.

122. PLN is losing money with every residential customer it connects outside the Java-Bali grid because the universal tariff structure prevailing in Indonesia with the cost of power supply

being substantially higher than the tariff.³³ Given the potentially large number of such consumers, there are limits to cross-subsidization by other consumer categories. Rural electrification thus runs counter to PLN's obligation as a SOE to make a profit.³⁴ The implication is that the Government's ambitious target of providing electricity to 95% of the population by 2025 will be difficult to achieve with the business-as-usual approach.³⁵ A new rural electrification strategy needs to be developed and implemented, based on innovative decentralized models for design, financing, implementation, and operation. Local development utilities, either in the form of a cooperative or a partnership between a BUMD and a private service provider, appear to be a promising approach. Recently, the Government has further encouraged the development and use of biofuels and renewable energy

5. Institutional Arrangements

123. The Electricity Law (20/2002) that supported policy actions toward the implementation of a competitive electricity market and the establishment of independent regulatory body was annulled by the Constitutional Court in December 2004. Provisions on competitive electricity market and unbundling of utility company were ruled as unconstitutional by the court. To address the uncertainty caused by the revoking of the law, Government Regulation (GR) 3/2005 was issued including most of the provisions stated in Law 20/2002 with the exception of the provision of competitive electricity markets and unbundling of PLN. Under the reinstated Law 15/1985, PLN is the single license holder for public electricity provider in Indonesia. Private sector participation is recognized, but limited to generation. Subsequent to the annulment of the electricity law of 2002, ministerial decrees were issued that allowed PLN to purchase electricity from private producers. The Government and the Parliament, in consultation with stakeholders, are now preparing a new electricity law. The draft of the new electricity law is with the Parliament and is likely to be approved by end 2006.

124. Through a series of electricity tariff increases,³⁶ renegotiation of IPP contracts,³⁷ loan restructuring, government subsidies,³⁸ and efficiency improvements, PLN managed to overcome the disastrous effects of the Asian financial crisis. However, the fuel subsidy removal in 2005 has had a major negative impact on the financial performance of PLN, which uses diesel oil for almost 20% of its generation. PLN has been unable to pass the recent sharp domestic oil price increases on to its customers. PLN estimates that without an electricity tariff increase, the subsidy would have to rise to the unsustainable level of almost Rp40 trillion in 2006. The

³³ Most of the off-grid regions are supplied by diesel power plants at a cost of over Rp2,000/kWh and are dominated by small residential consumers charged less than Rp600/kWh.

³⁴ Law on State-Owned Enterprises 19/2003.

³⁵ The average annual growth rate in the number of PLN's customers of 11.1% during the past 30 years has been impressive. However, there have been two different patterns of growth, namely, 15.3% per year during the pre-crisis period 1974-1997 and 6.4% thereafter. The sharply lower post-crisis growth has been attributable to investment financing constraints and PLN's profit-making obligation.

³⁶ The average electricity tariff was increased by 29% in April 2000, 17% in July/October 2001 and through quarterly adjustments of 6% each during 2002-2003. These increases brought the average tariff from about 2.5 US cents/kWh after the Asian financial crisis to 6.8 US cents/kWh in late 2003, a major accomplishment and proof of the successful socialization by the Government of this politically sensitive issue. Since then, the average tariff has decreased to 6.2 US cents/kWh due to rupiah depreciation and changes in the consumption structure.

³⁷ The renegotiations were a complex and protracted exercise with a successful final outcome. Out of the 27 IPP contracts totaling 11,300 MW, 14 contracts for 5,690 MW were continued under renegotiated terms, 6 contracts for 4,490 MW were terminated, 6 contracts for 900 MW were acquired by the Government and its SOEs, and only 1 contract for 220 MW ended in a legal dispute.

³⁸ The subsidies were introduced to compensate PLN for its low tariff for small consumers and amounted to Rp,4.7 trillion in 2002, Rp,4.1 trillion in 2003, and Rp,3.5 trillion in 2004.

Government intends to link the tariff increase, if any, to further improvements in PLN's efficiency, such as a reduction in the transmission and distribution losses from 11.3% in 2004 to below 10%.

125. The oil and gas law (22/2001) in 2001 brought about a fundamental restructuring of the oil and gas structure. The new law required that the upstream and downstream activities be regulated by separate, state-owned regulating bodies, and stipulated the use of natural gas for domestic uses. The country lacks adequate infrastructure to be able to utilize the natural gas domestically, and requires immediate investments for these.

126. The transition from a net oil exporter to an oil importer, and high international oil prices forced the Government to raise fuel prices by more than 100% in 2005. This was accompanied by cash subsidies to low-income households. The Government also announced the increased domestic use of indigenous natural gas to protect the economy from volatile world energy prices. The Government needs to adopt a flexible pricing policy for gas and should be in the form of guidelines that take into account several factors such as the opportunity cost of gas, the economics of production sharing contracts, the economics of fuel substitution, the economics of value added (for example, gas use for urea production), and toll fee of gas pipelines. Encouraging domestic use of gas will help in reducing liquid fuel consumption and subsidy payments. Small and marginal gas fields can be successfully developed to meet isolated domestic demand.

127. The Government recognizes that broad-ranging policy reforms are critical to improve the investment climate by, among other things, liberalizing markets to allow competition and entry by new investors, improving legal and regulatory certainty and strengthening regulatory arrangements, introducing tariff regimes based on full cost recovery, and establishing effective mechanisms for dispute resolution. The Government has taken a range of initial critical steps to set the pace for reforms. In February 2006, the Government released an Infrastructure Policy Package, based on the work done by the sector ministries, oversight agencies, ADB, JBIC,³⁹ and the World Bank.

128. The role of the high-level inter-ministerial National Committee for the Acceleration of Infrastructure Development (KKPPI)⁴⁰ has been strengthened. KKPPI's mandate is to formulate infrastructure strategies and policies, coordinate and supervise the implementation of these strategies and policies by the line ministries and local governments, formulate the PSO policy for infrastructure services, and solve problems that impede infrastructure development by the public and private sector.⁴¹

129. Recognizing the importance of private sector participation, individually or in partnership with the public sector, the Central PPP Unit under the KKPPI Secretariat will be responsible for ensuring policy consistency, quality control and transparency by establishing standards and principles that all transactions must follow, and by monitoring the execution for compliance.

³⁹ In May 2005 the Government of Indonesia and the Government of Japan jointly adopted a Strategic Investment Acceleration Plan to improve the investment climate, which includes a large number of infrastructure-related actions.

⁴⁰ The KKPPI, which reports directly to the President, is co-chaired by the Coordinating Minister of Economic Affairs and the chair of BAPPENAS, the latter acting as the executive chair. Its members include the ministers of finance, home affairs, energy and mineral resources, public works, transportation, communications and informatics, and state-owned enterprises, as well as the cabinet secretary.

⁴¹ Through the Presidential Decree 42/2005 issued in May 2005.

Given the massive investment needs against limited capital resources, another important responsibility of the Central PPP Unit will be to prioritize PPP projects according to their development impact and readiness for implementation. The Government has begun to develop a risk management framework for the infrastructure sectors as an instrument for assessing, pricing, monitoring and managing the contingent liabilities that arise from selective guarantees for PPP projects against risks related to policies and performance of the Government and its agencies. In view of the links to its existing budgeting, fiscal accounting and debt management systems, MOF is playing a key role in developing and implementing the framework.

130. Indonesia has to address different issues that will enable smooth implementation of the projects and programs. This requires formulation and implementation of guidelines. Important issues to address are the sharing of resources between regional and Central Governments, adequate cost recovery to ensure sustainability of the projects, due consideration for environmental and social safeguards. The legislation should clearly delineated transparently the jurisdiction between different agencies (among public and private), central, regional and provincial governments.

6. Role of Development Partners

131. The World Bank, ADB, and JBIC are the main multilateral/bilateral development institutions active in Indonesia. All three have historically provided strong support to the energy sector. With the onset of the Asian financial crisis the government's demand and absorptive capacity decreased. Since the acceleration of economic recovery from 2000 onwards the role of these institutions has regained its importance. JBIC has done over 130 energy sector projects in Indonesia since 1968 for a total amount of 800 billion yen. The energy sector accounts for 20.9% of JBIC's total lending to Indonesia.

7. Successes and Lessons Learned by ADB in the Sector

132. ADB had provided 29 loans with a total loan amount of \$3,200 million and 36 technical assistance projects for over \$14 million. The loans were primarily in the power sector with only one gas subsector project. OED evaluation studies based on PCRs and PPARs for the sector show that ADB has a comparative advantage in providing loans for energy, transport, communications, social infrastructure, and finance projects. It, therefore, should continue to target a substantial part of its assistance in Indonesia to support these sectors. The two loans approved since the crisis were sector projects which coincided with this strategy, combining policy reforms as well as several subprojects. ADB's current energy strategy is focused on the delivery of policy reforms, funding of critical infra-structure projects through public and private sector operations, and capacity building.

133. ADB continued to assist the Government during the financial crisis by revising the scope of work of ongoing projects inline with the existing requirements and adopting a flexible approach towards portfolio management. During the crisis (1998–2000), ADB's lending program included two projects in the energy sector. The two power projects, i.e., a program loan for Power Sector Restructuring Program (PSRP) (Loan 1673) and TA loan for Capacity Building for Establishment of a Competitive Electricity (Loan 1674) were part of ADB's prompt and comprehensive response to the financial crisis that hit Indonesia in 1997. A major setback to sector reforms was when the Electricity Law which was based on these loans, was revoked in December 2004.

134. In the power subsector, with few exceptions, the completed loan projects succeeded in achieving their expected outputs and immediate objectives including the provision of additional capacity to match load growth, the removal of transmission system constraints, improvement in system efficiency and reliability, increase in the use of indigenous energy resources, and resulting socioeconomic development. The TAs provided useful recommendations to the Government and PLN with respect to institutional strengthening, tariff rationalization, and sector restructuring. At the sector level, the lending was successful in improving the overall operating efficiency of PLN, not just the efficiency of the individual projects. While the assistance and its accompanying covenants were efficacious in enabling PLN to minimize costs of supply, reduce system losses, improve collection efficiency and make well-developed tariff proposals, they were often inefficacious in securing government approvals of such tariff proposals fully or in time, thus leading to financial shortfalls of PLN. However, the efficacy of the transmission projects is considered as less than satisfactory due to incomplete sections.

135. ADB has provided assistance to the energy sector to implement power transmission and generation projects, development of renewable energy sources, policy formulation, and development of gas transmission systems. ADB's private sector has financed facilities for liquefying natural gas. While the private sector has an important role to play in infrastructure financing, continued public sector investments will be required in areas that are socially relevant but fail to attract private resources, to create markets and encourage private sector development.

8. Current ADB Operations and Commitments

136. After the crisis (2001–2005), there were only two ADB projects in the energy sector, with a total project loan of \$301 million. The two power sector projects are Renewable Energy Development Sector (Loan 1982) and Power Transmission Improvement Sector (Loan 1983). The Renewable Energy Development Sector Project comprises various core and noncore subprojects that will add about 82 megawatts (MW) power generation capacity with 480 gigawatt-hour (GWh) annual energy output. Implementation of such subprojects will also help restore the power demand and supply balance, and improve the quality of power supply to existing consumers, particularly in the rural regions. The project will expand renewable energy use and thereby limit emission of greenhouse gases.

137. The Power Transmission Improvement Sector Project consists of various core and non-core subprojects that add 360 mega Volt amperes (MVA) of transformation capacity to remove substation capacity bottlenecks in Java-Bali, and 276 km of 150 kilovolt (kV) transmission line to interconnect power grids in the outer islands. Power transmission bottlenecks in Java must be removed and some small power grids in the outer islands interconnected to maintain quality of power supply and improve efficiency.

138. Although the loan signing took place on 10 November 2003, the loans for these two projects were effective in October 2004 only due to the delays in submitting formal subsidiary loan agreements (SLAs) to the Ministry of Finance and the respective legal opinions of the Ministry of Justice and PLN counsel on these agreements. The loan closing dates are in September 2008, however, due to the delay in declaring the loan effective these loans will have to be extended.

139. Private sector operations in the energy sector in Indonesia have been revived with the approval in December 2005 of a \$350 million loan to the Tangguh LNG project. The loan to the Tangguh LNG project was ADB's first PSOD loan to Indonesia since 1994 and is also the

largest single tranche loan by PSOD to date. In August 2006 another private sector loan to PT Perusahaan Gas Negara (Persero) for the South Sumatra to West Java Phase II gas pipeline project was approved. This included a direct loan of \$75 million and \$125 million under ADB's complementary financing scheme.

140. At present there are 5 TAs in operation that include development of local grids outside the Java-Bali network, improving the access of poor households to the electricity grid, use of palm oil mills waste for energy generation especially in remote locations, development of a public-private partnership project for gas transportation, and developing capacity in the relevant institutions to process CDM projects.

9. Proposed ADB Role in the Sector/Theme

141. ADB's strategy to support the development and growth of the energy sector will rely on its public and private sector lending instruments as well as mechanisms introduced under the innovative efficiency initiative. The following areas will be the focus of ADB's operations:

- (i) policy-based lending for infrastructure based on the Government's reform agenda;
- (ii) support for use of domestic reserves of cleaner fuels (natural gas, coal bed methane) and renewable energy resources (geothermal, biomass, solar, wind, small and mini hydropower);
- (iii) public-private partnership in projects where confidence building and a risk-sharing mechanism is required;
- (iv) assistance for natural gas transportation infrastructure;
- (v) support electricity generation projects including IPP projects;
- (vi) transmission lines to improve system reliability, efficiency and to connect isolated load centers to the grid;
- (vii) efficiency improvements in electricity systems;
- (viii) developing efficient oil storage and transportation infrastructure;
- (ix) private sector operations in the upstream sector;
- (x) promote regional energy cooperation to optimize resource availability; and
- (xi) close coordination with other major institutional lenders to maximize developmental impact of the assistance.

10. Proposed Sector Outcomes and Outputs to be Supported by ADB

142. The Government's main targets for the energy sector are rationalization of energy prices, development of new and renewable energy sources, self sufficiency in energy leading to security of supply and lower price volatility, improved energy efficiency development of domestic energy sector and infrastructure, and increased access to energy for all. In order to achieve these targets active participation by the private sector is essential and this will require establishing appropriate sector regulations and implementing rules and regulations. ADB is supporting these reforms and the restructuring process through the proposed Infrastructure Reform Cluster Program. A loan is also planned to improve the efficiency of power distribution, as well as energy efficiency improvements through demand side management initiatives. Other potential projects include gas pipelines, development of renewable energy and coal fired generation with public and private sector participation.

11. Links to Overall CSP Outcomes and to other Sectors/Thematic Areas

143. The objective of ADB's assistance over 2006-2009 is to support a policy and business environment for promoting sustainable, efficient and equitable growth. Provision of energy services is an essential input for economic development, job creation, improving the quality of life, and human resource development. The energy sector interventions will contribute to this by providing an improved energy infrastructure, including those in remote and rural areas, and effective utilization of resources.

12. Opportunities to Address Environment Concerns

144. The sector can contribute significantly in addressing local and global environmental concerns. The proposed Energy Law emphasizes development of renewable sources of energy and enhancement of efficiency in energy supply and use. The country can access new international financing instruments like the clean development mechanism and other funds for promoting clean energy. Besides enabling access to international funds, clean energy project deliver a double dividend through local environmental benefits and access to advanced technology leading to development that is sustainable. ADB can provide support through its Carbon Market Initiative, the Asia Pacific Carbon Fund (APFC), and the Energy Efficiency Initiative.

13. Proposed ADB Activities

145. During 2006-2009, ADB is planning to provide financing for six new projects relevant to the energy sector in an amount of about \$1450 million. During the same period, financing will be provided for three TA projects totaling \$ 4.5 million.

Table A4.9: Energy Sector Road Map Results Framework

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country ^a	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators for Sector	Milestone (Tracking) Indicators	Interventions
Expanded and efficient energy infrastructure	<p>Opportunities: Significant indigenous energy resources</p> <p>Constraints: inadequate investment and low level of private sector participation</p> <p>Constraints: lack of clarity on regulations and implementation rules</p>	<p>Higher and equitable sustainable growth leading to poverty reduction through:</p> <ul style="list-style-type: none"> – Improved energy infrastructure – Energy self sufficiency and increased access to energy resources – Improved regulatory framework 	<ul style="list-style-type: none"> – Improved quality and reliable availability of energy – Higher level of private investment in the energy sector – Improved electrification ratio – Reduced energy import dependence. 	<p>Infrastructure Reform Program</p> <p>Energy Efficiency Improvement Project</p> <p>Gas Transportation through Public Private Partnership</p> <p>Hydro Power Development</p> <p>Development of Alternative Energy Sources</p> <p>Development of Power Transmission and Distribution</p>

^a Only outcomes relevant to ADB's road map and CSP are listed in this results framework.

Source: Asian Development Bank

F. Financial Sector

1. Summary Sector Overview

146. The financial sector has gone through major restructuring and reform since the financial crisis in 1997-1998. The banking sector has been consolidated with the number of banks halved, and the dominant state-owned banks have been recapitalized and strengthened. Nonperforming loan ratios have come down substantially to 3.4% in private banks and 15.1% in state-owned banks as of September 2005. State-owned banks cannot take haircuts, or discounts, on sale of their NPLs and that has limited NPL resolution. The banking sector still dominates the financial system with almost 80% of total assets. The nonbank financial sector, while small, is poised to grow. The Government is actively supporting growth of nonbank financial institutions (NBFIs) to diversify the financial sector and improve mobilization and intermediation.

147. The stock market is small in terms of capitalization to GDP at about 30% compared with around 70% in Thailand and 150% in Malaysia, but it has been booming over the past five years. While 355 firms are listed, trading is mainly done in the 30-40 most liquid stocks. One reason for the low liquidity is the small free float of listed shares. Foreign institutions account for more than half of the trading volume, and there are an estimated 90,000 retail trading accounts in Indonesia. In March 2006 the merger of the Jakarta and Surabaya exchanges was announced.

148. The bond market is dominated by the Rp309 trillion recap bonds for the state-owned banks. Outstanding government bonds amounted to 19% of GDP at the end of 2005. The secondary market has grown since banks have been selling and mutual funds buying recap bonds following a lifting on the trading limits on them. Trading is done largely over-the-counter and a little bit at the Surabaya stock exchange. Trading has been thin partly due to the lack of benchmarks for pricing and poor price discovery and transparency. Corporate bond issuance started growing in 2002 but is still small with outstanding bonds amounting to 2% of GDP at the end of 2005. Mutual funds started growing in 2000 when mutual funds were allowed to buy more recap bonds, and banks started promoting mutual funds to depositors. The net asset value of mutual funds increased rapidly until the end of 2004 although there was a substantial sell off in 2003 as stricter accounting for banks contingent liabilities to mutual funds and mark to market requirements were introduced. In 2004 mutual funds grew again only to face another round of redemptions during 2005 as interest rates rose. New regulations were introduced in 2004 but these fall far short of what is needed to properly regulate the industry.

149. The insurance industry is small in terms of premiums to GDP at barely 2%, and total assets equivalent to 3% of GDP. As of September 2005 there were 51 life insurance companies, 97 non-life and 4 reinsurance companies. In addition there were two companies to administer social security and 3 to manage civil servants and armed forces insurance. The industry is heavily concentrated with the top five non-life companies accounting for 51% of assets and the top five life insurance companies accounting for 55% of assets. The industry is not healthy financially with five insolvent non-life companies and six insolvent life companies that are still operating. Bumiputera alone was estimated to have a solvency shortfall of \$300 million in 2003.

150. Insurance companies currently invest an estimated 25% of their assets in short term deposits. The pension funds industry is also small with assets equivalent to 4.5% of GDP. In terms of assets it is equally split between the state run funds for civil servants (Taspen), the

armed forces (Asbri) and Jamsotek that provides lump-sums on retirement, and private pension funds. The new law on social security form 2004 paves the way for reform of pension funds, however, implementation is rather fluid. Pension funds currently hold about 50% of their assets in short term deposits.

2. ADB's Involvement Since the Financial Crisis and Lessons Learned

151. ADB's ongoing work in the financial sector stems from the financial crisis. The immediate support following the crisis was part of the multi-donor package to assist Indonesia in restructuring the banking sector and improving financial and public sector allocation of resources by strengthening governance, increasing disclosure and transparency of financial information and reinforcing the financial sector's legal and regulatory framework. After the multi-donor initial package of support, ADB moved towards supporting development of the nonbank financial sector (NBFS), and ceased its involvement in the banking sector.

152. Following the immediate crisis response the focus shifted to medium term issues in the financial and corporate sectors with a strong focus on addressing the weaknesses in governance exposed during the financial crisis. The main areas of support include:

- (i) continued support to develop the NBFS in order to diversify financing sources. The TA and programs focused on strengthening regulation and supervision of NBFIs and supporting the establishment of a consolidated financial sector supervisory authority;
- (ii) strengthening financial governance including anti-money laundering policies and procedures;
- (iii) assessment of social security schemes in need of reform and strengthening with audits of pension schemes and a reform focus on the insurance sector;
- (iv) support state-owned enterprise reforms including corporate governance, commercialization of public service obligations, and restructuring, establishing fair and transparent labor practices, and strengthening and effectively enforcing procurement guidelines for SOEs; and
- (v) support Small and Medium Enterprises (SME) development with a focus on industrial competitiveness and export development.

153. In addition fiscal management and governance has been supported through:

- (i) state audit reform program to strengthen the State Audit Board; and
- (ii) local government finance program to strengthen the policy, legal and regulatory framework for decentralization and develop capacity at local government level.

154. Potential lessons learned point to the need to work closely with the Government on priority reforms, provide substantial TA to support preparation and implementation of key reforms.

3. Key Development Issues and Challenges

a. Inadequate Regulatory and Supervisory Framework

155. Since the crisis, a lot of effort has been put in to strengthening regulation and supervision of financial institutions. The overall goal is to set up a consolidated regulator for the financial sector, the OJK. The starting date was initially 2003 but has been postponed to 2010.

In November 2004, the Government decided to merge the directorates for pensions and insurance under the Ministry of Finance with the capital markets regulator, Bapepam, to form a nonbank financial sector regulator. The presidential decree to effectuate the merger was signed in November 2005 and this was followed by a finance minister's decree detailing the organizational structure and staffing for the merged entity called Bapepam LK. Bapepam LK is still under the Ministry of Finance and does not have the independence that Bank Indonesia (BI) has. To achieve independence as well as flexibility in organizational structure, staffing, and salaries (i.e., move away from the civil service system) and become more like BI, legal changes are likely to be necessary. It is recommended by the legal consultants that the draft OJK law be brought to Parliament for enactment, indicating that Bapepam LK is the precursor to OJK, and that banking supervision will be brought in later. As an interim measure to the possible enactment of the OJK law, it appears that a Government regulation will be issued to put Bapepam LK on par with the deposit insurance agency LPS, providing a certain amount of independence.

156. Regulations and supervisory practices for the nonbank sector are gradually being strengthened and brought in line with international standards, but additional work is needed to comply with IOSCO principles for securities, IAIS core principles for insurance, and OECD guidelines for occupational pensions. The Capital Market Law, Insurance Law, and Pension Fund Law are all being amended, and some provisions are needed to allow for the necessary regulatory changes to meet international standards. In addition, while risk-based capital is in place for insurance companies, it is not utilized. Minimum capital levels are not strictly adhered to, either, fragmenting the industry into many small, poorly capitalized companies, and larger, technically insolvent companies.

157. The legal and regulatory environment for mutual funds is woefully inadequate. The law is an amalgam of US regulations for corporate funds (which do not exist in Indonesia) with few references to contractual funds, which is the legal structure of all mutual funds in Indonesia. There is thus a clear need to rewrite the sections of the Capital Market Law that pertain to mutual funds and the associated regulations. Draft legal amendments and regulations have been prepared by consultants under TA 3850-INO⁴² and will be completed in May 2006. It is critical that this framework be strengthened to restore investor confidence in mutual funds and to develop the mutual fund industry.

158. BI has moved toward full compliance with the Basel Core Principles for Banking Supervision and has a road map for gradual implementation of the revised capital framework for banks, commonly called Basel II. BI has also strengthened its supervisory capacity significantly. To be better prepared to handle and manage a potential systemic crisis a financial safety net will be put in place. The deposit insurance agency (LPS) was set up in September 2005 to phase out the blanket deposit insurance introduced during the crisis and introduce a limited deposit insurance scheme. A provision for a lender of last resort facility in BI is under way. The Financial Sector Forum, with representation from BI, LPS, and MOF, is the interagency forum tasked with sharing information between the regulatory agencies and with managing a systemic crisis.

159. Enforcement of regulations in the financial sector is inadequate. For Bapepam LK, in particular, the consultant under TA 3850 has recommended streamlining of investigation

⁴² ADB. 2002. *Technical Assistance to Republic of Indonesia to Support for Non Bank Financial Governance Program*. Manila. TA 3850, approved on 18 March 2002, for the amount of \$1.5 million.

procedures and the organizational setup to ensure better flow of information so that administrative sanctions can be imposed more easily. For suspected criminal offenses, there needs to be improvements in coordination and cooperation with the judicial branch. To put these changes into effect, some amendments are needed in the Capital Market Law.

160. The number of mainly rural village microfinance institutions (MFIs) is estimated to be as high as 48,000. Despite being called "institutions", they are mainly loosely organized operations that are unlicensed and unregulated. Financial cooperatives are nationally regulated by the Ministry of Cooperatives and SMEs, but in practice, there is no effective supervision for either financial cooperatives or the other many forms of MFIs. These informal and unregulated MFIs compete mainly with BPRs, although the latter are licensed and supervised by BI and operate on a sustainable commercial basis. The unregulated MFIs often participate in subsidized lending programs promoted by a variety of government and charitable agencies; the effect is distortion of micro and rural financial markets, which impedes banks and BPRs from moving "downmarket". Suggestions to provide some kind of regulatory and supervisory scheme to cover the unregulated and unsupervised MFIs run into two strong barriers. First, in aggregate MFIs do not pose any systemic threat to the financial system. From a risk-based perspective, it is hard to argue for a large and costly intervention. Second, there is no private or government agency with the capacity or inclination regulate and supervise MFIs. Still, the MFIs are important because they serve more people than do formal financial institutions.

161. The legal framework for insolvency is inadequate and the judiciary's capacity to manage financial sector cases is weak, which hampers resolution of nonperforming assets. IBRA reportedly lost nearly 90% of its court cases. Underfunding of the courts, insufficient capacity and knowledge of financial sector issues, and a lack of transparency of court cases and verdicts have been identified as the main problems.

b. Governance and Transparency

162. Corporate governance falls short of OECD principles but is gradually being improved. ADB supported development of a corporate governance code for state-owned enterprises, and the listing requirements for the Jakarta stock exchange with respect to governance were strengthened for several years, but progress stagnated in 2005 according to studies by CLSA. State-owned banks have governance issues as evidenced by scandals during the past few years. The internal and external oversight of state-owned banks is not clear, neither in terms of reporting arrangements from the Boards to the Ministry of State-Owned Enterprises and MOF, nor how these ministries exercise ownership control. Internal and external auditing seems to be inadequate. In the nonbanks sector disclosure requirements are also inadequate and need to be strengthened. The move to fully introduce the International Accounting Standards (IAS), and most critically IAS 39 on market-to-market provisions, and the International Financial Reporting Standards, is targeted for 2008. It will help improve governance and transparency, provided that financial institutions, accountants, and regulators have sufficient capacity to apply the new standards.

c. Capital Market

163. Apart from regulation, supervision, and enforcement, a key issue for the capital market to develop is bond market development. Issuance of government securities can be improved with a coherent policy for debt issuance, development of a proper primary dealer system, and establishment of the infrastructure to support the primary and secondary market for government debt securities. The secondary market needs to be developed to ensure transparency and

efficiency of price discovery through an electronic platform. An action plan has been developed to address the trading mechanism and the market infrastructure to achieve straight-through processing. While the small corporate bond market has grown, pricing has difficult without a clear benchmark, but improved government bond issuance can address this. With the need for long-term finance for infrastructure, for example, it is critical that the functioning of the bond market is improved. Pension funds and insurance companies are potential investors in long-term debt securities.

d. Nonbank Financial Institutions

164. There are weaknesses in insurance and pensions. While there are many insurance companies, the sector is fragmented, with high concentration of assets among the five largest companies, both in non-life and life. There are also many small poorly capitalized companies and insolvent larger companies. The sector has potential to grow since insurance penetration is low. However, the sector needs to be consolidated by addressing the insolvent companies, fully implementing the strengthening minimum and risk-based capital requirements for all companies. In addition, investment guidelines need to be revised to allow for more investment in highly rated securities. For pension funds, there is a need to strengthen regulations for private funds and to address weaknesses in the state-run funds, and to revisit investment guidelines.

e. Micro- and SME Finance

165. Growth of micro- and SMEs is hampered for several reasons. SMEs are subject to highly indeterminate registration and tax regimes (owing in part to decentralization), creating strong incentives for SMEs to remain within the informal sector, which effectively precludes them from accessing formal sources of financing, e.g., from commercial banks. Commercial banks, in turn, have strong incentives in the form of capital requirements to invest in restructuring bonds and government securities rather than moving into the more costly business of SME lending, even though it is a largely untapped market segment with good long-term potential. In addition, there is as yet no comprehensive credit information bureau that can support microenterprises and SMEs in building a credit history. BI will set up a credit information bureau in 2006. Systems for collateral registration will facilitate access to finance for SMEs. There are significant deficiencies in the secured transactions framework that present formidable barriers for microenterprises and SMEs. The percentage of titled rural land is the lowest in the region, a clear impediment to collateral-based lending. Microenterprises and SMEs often present inadequate business plans and sets of accounts to banks. Business development services have been a favored measure to address these, but in some countries the results have been disappointing, and it has proved difficult to operate BDS on a sustainable basis. Inadequate infrastructure impacts business development. Microenterprises and SMEs in Indonesia are highly informal and are neither growing nor generating jobs. Official interventions to support Microenterprises and SMEs must, therefore, take a long-term view that focuses on creating conditions for these small, largely informal operations to move toward greater formality, with a stronger legal basis supporting their increased access to finance.

4. The Government's Policy and Planning Framework

166. Strengthening and development of the financial sector is a priority for the Government, which is due to launch a financial sector policy package in June 2006. The draft version of the package received in May point to sets of reforms and policy actions in

- (i) financial system stability;
- (ii) banking institutions;
- (iii) nonbank financial institutions;
- (iv) capital market development;
- (v) financing for micro and SMEs;
- (vi) infrastructure finance;
- (vii) taxation; and
- (viii) export finance, SOE privatization, and investor relations.

167. The draft policy package lists a number of actions for the short term but lacks the longer-term vision and goals for the financial sector. The package also raises questions on some overall strategic issues such as sector-specific strategies or assessments that underpin the policy actions in the package. These include a strategy for state-owned banks, the role of the regional development banks (BPDs), and the BPRs, the overall taxation of financial services, and the framework to facilitate microenterprise and SME lending. For the latter, the document suggests a top-down structure in estimating SME finance needs instead of a market-driven approach supported by Government-sponsored measures such as establishing a credit bureau, facilitating collateral registration, and encouraging the banking association to develop methodologies for judgmental credit scoring and credit underwriting for SMEs. There is a need for greater clarity in the legal and regulatory framework for MFIs, but this could become less critical were BPRs, BPDs, and commercial banks to develop more effective outreach strategies. BI must revise some regulations that restrict branching by BPRs. Ironically, though the performance of the commercial banking sector has improved dramatically of late, helped in part by large influxes of foreign capital and expertise, there is a legal prohibition against foreign-based entities providing any kind of funding to BPRs, another example of an uneven legal playing field, with adverse consequences for rural Microenterprises and SMEs.

168. There is no reference to the need for mutual fund regulation. Following the run on mutual funds in 2005 where assets dropped by 80%, it is curious that this is missing from the policy package, as reform was a priority for the previous Bapepam chair and has prompted work on strengthening the bond market, particularly the price discovery process. It is imperative to reestablish investor confidence in funds.

5. Role of Development Partners

169. World Bank and AusAID are the two main development partners active in the financial sector. The World Bank supports product development aspects in the nonbank financial sector and has provided support to debt management. AusAID has also provided extensive support to the debt management office, and is supporting Bapepam-LK with a series of internships and staff exchanges between Bapepam-LK and the Australian supervisory authorities. AusAID also has extensive funding for economic governance technical assistance and has provided support for corporate governance and trade initiatives. GTZ provides extensive TA support through BI for microfinance. Ongoing support focuses on research, training, and policy work on micro- and rural finance.

6. Indonesia's Capacity and Approach to Managing for Development Results

170. Capacity among regulators in the financial sector has been strengthened since the crisis. BI in particular has substantially enhanced regulation and supervision. Bapepam-LK will be in a better position to harmonize regulation and supervision of the nonbank financial sector, achieve synergies among its staff (such as legal expertise, enforcement processes), and coherently

pursue policy for the sector as a whole. Indonesia issues 5-year capital market development plans that provide the direction and specific actions to be achieved. These seem to be followed, but actions requiring legislative measures are beyond the control of the regulator as are some policy issues. The regulator must be able to respond to market developments.

7. ADB's Ongoing Support in the Financial Sector

a. Legal, Regulatory, and Institutional Framework in the Nonbank Financial Sector

171. ADB has developed a strong track record working with Bapepam LK in the nonbank sector through numerous TA projects and support for reforms under program loans. ADB has supported strengthening of regulations and supervision of pension, insurance, and mutual funds, as well as enhanced risk management, enforcement processes, and recommendations to amendments to the Capital Markets Law, Insurance Law, and Pensions Law to strengthen the legal framework.

b. Local Government Finance and Decentralization

173. The Local Government Finance and Governance Reform Sector Development Program aims to enhance the effectiveness and efficiency of delivery of basic public services by strengthening the policy, legal, and regulatory framework for decentralization as well as developing local government capacities. Phase 1 of the program aims to increase accountability in the management of local government finances and is structured around five key outputs to achieve (i) enhanced intergovernmental coordination and development of a national action plan for fiscal decentralization (NAPFD); (ii) a strengthened and harmonized framework for regional autonomy; (iii) a strengthened, rationalized, and harmonized framework for intergovernmental fiscal relations; (iv) a strengthened and harmonized framework for planning, budgeting and financial management; and (v) an enhanced awareness of public expenditure and financial management (PEFM) reforms and modernization of FMIS.

174. A project loan forms part of the program, which aims to support implementation of reforms in PEFM under phase 1 through development and upgrading of related FMIS. The project consists of five components: (i) upgrade and expand electronic access to the regional financial information system (SIKD) by 100 local governments; (ii) computerize the new Directorate General of Regional Financial Management (DG BAKD), at the Ministry of Home Affairs (MOHA) to enhance oversight of PEFM reforms; (iii) develop and implement regional financial management information systems (SIPKD) in 71 local governments; (iv) streamline and computerize the system at the Ministry of Finance (MOF) for review of local government regulations (*perdas*) and draft *perdas* on taxes and charges for consistency with higher laws and regulations; and (v) develop certification program at MOF for regional financial administrators.

c. Housing Finance

175. A project is under processing to support the Secondary Mortgage Facility. The objective is to support the depth and breadth of the mortgage market through securitization. PT Sarana Multigriya Finansial (PT SMF) was established in 2005 with capital of Rp1 trillion from the Government. PT SMF will purchase loans from financial institutions and securitize them into mortgage backed securities (MBS) for sale in the bond market. In the initial stages, PT SMF will make long-term loans to financial institutions that adopt its standards for mortgage underwriting

and documentation. As the pool of qualifying mortgages accumulates and becomes seasoned, PT SMF will purchase the mortgages for securitization. The company may also act as guarantor for MBS. ADB will provide non-sovereign finance of tentatively \$50 million through the Multitranche Finance Facility.

8. ADB's Proposed Role to Support the Government's Financial Sector Strategy, 2006–2009

176. **Financial Governance and Social Security Reform Program (FGSSR) II and III.** These programs would follow the FGSSR I, approved in 2002, and further reforms started in financial sector regulation and supervision, governance matters including accounting and anti-money-laundering policies, and development of a national social security system. TA 3850-INO (see footnote 42) supports strengthening of regulation and supervision in the nonbank financial sector and policy actions in the Action Plan for the nonbank sector, which was an end program action in the FGSSR I loan completed at the end of 2004. The TA reports on pensions, insurance, securities risk management, mutual funds regulation, enforcement, training and capital market legal and regulatory reforms include a number of forward-looking policy reforms and actions to include in the FGSSR II. Informal requests have been made to support development of regulation for Islamic financial services.

177. For the social security component, tentative policy actions could relate to the implementation of Law 40 on Social Security enacted in November 2004, which calls for issuance of a number of regulations. TA provided to support the implementation of FGSSR may also provide forward-looking actions to be incorporated into the program, such as support for a social security number system, a national social security council with overall responsibility for government-sponsored social security programs envisaged in Law 40 but yet to be created, and potential reforms of government-sponsored social security and pension systems.

178. **Non-sovereign Lending for Microfinance and SME Finance.** The objective of the proposed Rural and Microfinance Loan Project is to expand outreach of microfinance services to micro- and small enterprises in rural areas. Using the local currency product, a rupiah loan of \$50 million equivalent will be provided to PNM (state-owned SME finance corporation) as an apex institution for rural banks. Through its Earthquake and Tsunami Emergency Support Project's (ETESP) livelihood and microfinance component, ADB is already working with PNM to channel funds to sustainable BPRs in Aceh. The proposal is to work with PNM to expand access to finance by selected rural banks, by providing both subordinated debt, allowing them to leverage their capital, and working capital, to expand lending. the Government is expected to launch a policy package for microfinance in June, which will indicate the key policy areas that could be considered for support.

179. **Local Government Finance and Governance Reform II.** To further the reform agenda developed under Local Government Finance and Governance Reform Program I, approved in November 2005. The objective is to continue to support the policy, legal, and regulatory framework for decentralization, intergovernmental fiscal relations, and enhance the framework for public expenditure and financial management. A more detailed discussion is in the road map for decentralization and subnational government administration.

180. **Municipal Finance.** The objective is to support formulation and adoption of a framework on municipal finance, an assessment of the ability of local governments to borrow. A demand assessment has been completed, but additional work of the capacity of local governments to manage their finances needs to be done, and a PP on LG bonds needs to be adopted.

G. Urban Infrastructure Sector

1. Introduction

181. The purpose of this road map is to describe the key issues and challenges in urban infrastructure (water supply, sanitation, solid waste management, and urban renewal), the Government's and the private sectors response to these challenges, and how ADB proposes to work with the Government and other stakeholders to address these challenges in 2006–2009. The road map is based on consultations held with central and local government agencies and other stakeholders over the years, and findings of ADB TA, and loan projects prepared and implemented. Key government agencies for the sector include in particular the National Development Planning Agency (BAPPENAS), Ministry of Public Works (MPW), Ministry of Public Housing (MPH), Ministry of Home Affairs (MOHA), Ministry of Health (MOH), and Ministry of Finance (MOF).

2. Summary Situation Analysis

182. Indonesia's urban population in 2005 was estimated at 107 million, or about 48% of the total population, with the largest urban agglomeration in and around Jakarta, and other provincial capitals such as Bandung (West Java), Semarang (Central Java), Yogyakarta (Special Yogyakarta Province), Surabaya (East Java), Medan (North Sumatra), and Makassar (South Sulawesi). Within the next 10 years, these large agglomerations are projected to grow considerably, which is likely to aggravate the human settlement situation. In 2001, some 23% of all urban households live in slum-like conditions, without access to secure tenure. This figure hints at the serious dysfunctions of the housing and land market, which force such a large proportion of families to seek informal residential arrangements.

183. Among the various infrastructure sectors, water supply and sanitation are in the worst technical and financial condition, with coverage levels and standards well below comparable countries in the region. Urban water supply is provided by about 318 regional government water enterprises (PDAMs), while sanitation services are usually provided by the regional government⁴³ administration through the Park and Cleaning Services Agency (DPK).⁴⁴

184. PDAMs supply water through just over 6 million connections nationwide. Piped water supply is estimated to cover only about 39% of the urban population, with 61% served through alternative small-scale water providers, or self-provision on household and community level. Households and commercial businesses in many Indonesian towns are able to rely on groundwater, although in the larger cities this practice should be discouraged where water quality is low or there are problems of ground subsidence.

185. Most PDAMs are struggling with their deteriorating financial situations and service quality. About 70% of PDAMs are heavily indebted and urgently require restructuring of nonperforming loans. In many regional governments, water tariffs are well below cost-recovery levels, often not even covering operation and maintenance cost, and unaccounted-for water is at a high average of 40%.

⁴³ Regional governments are either cities [*kota*] or districts [*kabupaten*].

⁴⁴ There are few examples where PDAMs are also responsible for sewerage services, including Kota Bandung and Kota Medan.

186. Sewerage systems have been constructed in selected areas of a few large cities, but planned benefits of these systems have not been realized. Most are underused and underfunded, and generally the whole sanitation sector is virtually unmanaged. Overall sewerage coverage is less than 1.5% of the urban population. The vast majority of citizens rely on on-site sanitation (communal septic tanks, individual septic tanks, and pit latrines); many other low-income families rely on grossly polluted drains and urban waterways. Sludge from septic tanks is removed by small private operators and mostly discharged into the nearest drain or river because treatment facilities are either unavailable or else too far away.

187. The great majority of rural households rely on self-provision through shallow groundwater abstraction, rainwater collection, or use of surface water from nearby rivers and springs. Only about 27% of rural households claim to regularly use toilet facilities; many more poor than nonpoor people lack access to adequate sanitation. Community-managed systems serve about 30% of the rural population, mostly through their own efforts or with the support of national and/or donor funded initiatives. The participatory rural initiatives may teach urban poor communities how to access clean, affordable water and to ensure that future investments are financially robust.

188. Solid waste management, including collection and treatment of garbage, is another cause of concern. In general, solid waste management suffers from (i) low levels of investment, (ii) low standards of collection and transportation, (iii) poor community attitudes toward garbage disposal, (iv) the burning of garbage in neighborhoods and at final disposal sites that contributes to severe air pollution in many cities, (v) almost all solid waste disposal being conducted in complete disregard of regulations and acceptable practice, and (vi) fragmented institutional responsibility with several local government agencies involved. A large proportion of solid waste is discharged into city watercourses (rivers, canals, and drainage channels), which should undergo a general cleanup under a sanitation program. Effective solutions will need to be developed to ensure that wastewater collection and treatment and solid waste management components are improved under integrated programs.

189. Demand for housing, land, and infrastructure is increasing rapidly, and most urban areas cannot provide the necessary facilities, physical infrastructure, and social services. Housing finance opportunities are inadequate, and estimates indicate a shortfall of 6 million houses. Crucial to success in delivering affordable shelter to the poor and low-income groups is the development of systems to consolidate and develop land and to finance this process. Private sector inputs to municipal infrastructure development are below expectations, and are likely to remain modest in the medium term. Compounding the lack of resources, local urban management and governance has improved little over 15 years of integrated urban infrastructure development programs (IUIDPs). Nevertheless, most human settlements are being developed through efforts of the private sector, either informal community initiatives or the real estate sector, while the role of government is increasingly limited to upgrading and improvement of poorly developed informal settlements, and to facilitation of private real estate investments and to coordination of privately and publicly provided infrastructure networks and services. As Indonesia is recovering from the fiscal and economic crisis of 1997–1998, since 2003 a new construction boom has emerged, which is reflected in an increasing demand for home construction.

190. Public sector–supported housing finance, through housing loans and mortgages, is still small and limited to public sector employees or middle-income families. Efforts to broaden the outreach of public sector housing finance to lower-income households, like those supported

through ADB-funded Neighborhood Upgrading and Shelter Sector Project (NUSSP), are still limited in outreach. However, various private banks have started during recent years to offer housing finance to its clients, and the market is growing.

3. Key Development Issues and Challenges

191. Indonesia's population is about 221 million, with more than 100 million living in urban areas. By 2015, the population will have increased to about 250 million, and the share of the urban population is expected to increase to about 60% (up to 140 million).

192. Large cities form the nucleus of the regional economies, supplying services and acting as markets and transport hubs. However, many of even the big centers are profoundly under-resourced. Almost half of urban households may be vulnerable to poverty, and urban economies are losing global competitiveness. Local governments are profoundly under-resourced for the challenge. The municipal credit market has failed, the central Government has almost entirely ceased special grants to local urban governments, and private sector participation is limited. Consequently, investment in municipal infrastructure has stalled and municipal services are declining.

193. The Water Supply and Sanitation (WSS) sector in Indonesia is in a very weak state, a condition that existed before the economic crisis in 1997/98 and still has an impact. Partly because of the parlous financial condition of many PDAMs, but also the evolving legal framework and uncertainties in the early stages of decentralization, investment in the urban water supply sector has been insignificant for the last 10 years, and the systems have deteriorated because of inadequate maintenance and repair. Low coverage of piped water supply and proper sanitation, together with the gross pollution of water resources are the main problems to be addressed.

194. With decentralization, delivery of WSS services is now the responsibility of local governments. The decentralization program is founded on the premise that devolving responsibility for local service delivery will improve service delivery. However, this will happen only if local governments receive adequate technical support, improve their governance and financial management performance, and mobilize financial resources, which is not the case. Separation of ownership and management of local government utilities to increase their performance and accountability, along with objective determination of tariff levels to support cost recovery, will be required before additional financial resources can be effective.

195. For the water and sanitation subsector, the ultimate challenge lies in achieving goal 7, target 10, of the Millennium Development Goals (MDGs): to halve, by 2015, the proportion of the people without sustainable access to safe drinking water and basic sanitation. Major reforms and sustained investment in the sector will be required to achieve these targets. For the urban renewal subsector, target 11 of the MDGs aims to improve the lives of slum dwellers.

196. The human settlement sector needs two-pronged support: (i) land development and urbanization schemes to the tide of large informal settlement developments and steer them into guided land development of serviced sites; and (ii) strengthening of the primary mortgage market, which will be able to reach to low- and middle-income households at the same time. Both these initiatives of land development and mortgage finance can be implemented through public as well as private entities.

4. Government Policy and Planning Framework

a. Policy Framework

197. The national Government is trying to improve the framework for urban infrastructure service provision. For water and sanitation, this started with promulgation of a new water resource law (Law 7/2004) in 2004 and a Government regulation (Peraturan Pemerintah [PP] 16/2005) on drinking water in March 2005. The regulation, among other matters, requires the PDAMs to provide “drinking” rather than “clean” water, giving 2008 as the deadline to develop this service. It also outlines a legal and regulatory framework for water and sanitation, in which policy making, regulatory, and service provisions are better delineated, and planning highlighted and cost recovery moved center stage. A new law on regional government owned enterprises (BUMD) is also being drafted, providing for greater managerial autonomy of PDAMs vis-à-vis the regional governments. Other implementing regulations for Law 7 and PP 16 are to be finalized by the end of 2006.

198. In 2003, the Government signed off on the National Policy for the Development of Community-Managed Water Supply and Environmental Sanitation Facilities in Services, initiated by BAPPENAS and supported by MOHA, MPW, MOH, the Ministry of Environment, and MOF. A second policy on institutionally based water supply and environmental sanitation is being finalized. The policies are to be jointly issued as a presidential instruction on water supply and sanitation in 2007, effectively serving as the “blueprint” for the sector.

199. For the urban renewal subsector, the Government’s most recent shelter initiative is the National Movement for One Million Houses, which aims to provide affordable housing and improving associated infrastructure. This involves programs for improving access to land, housing, housing finance system developments, and institution building. The program focused on facilitating the provision of serviced land (KASIBA LISIBA). The aim is to encourage local governments to manage urban growth, develop primary and secondary infrastructure, and facilitate the construction of low-income housing by private developers, cooperatives, and communities. The National Urban Development Policies and Strategies, issued as Ministerial Decree Ministry of Public Works 494/PRT/M/2005, reconfirm the Government’s commitments to the UN Habitat Declaration of 1996, UNEP’s Local Agenda 21 of 2002, and MDGs.

b. Legislation and Regulation

200. Law 5 of 1962 provides for PDAMs to be established through district or city legislation, either as BUMDs or as regional limited companies (MUMDs).⁴⁵ Local governments are responsible for setting tariffs. The delineation of responsibilities between regional governments and the BUMDs is not clear, resulting in many regional governments supplementing their budgets with “dividends” from PDAMs. As a result, PDAMs have no incentives to manage their resources effectively as these can be extracted by the regional governments at any time. The revised law, being prepared for submission to the Ministry of Justice, provides for greater autonomy of BUMDs and for reinvestment of revenues in the company.

201. Health Law 23 of 1992 addresses provisions for the health aspects of urban sanitation, which are developed through a regulatory framework prescribing the requirements of water quality, and sanitation coverage. It enables MOH to set minimum standards for drinking water

⁴⁵ Limited liability company owned by a regional government.

quality. Under this law, MOH monitors and regulates all water supplied to the public,⁴⁶ whether by PDAMs, private operators, private providers, and other intermediate providers, although water-bottling stations are regulated by the Ministry of Industry.

202. Law 23 of 1997 on Environmental Management increases the legislative power of government and recognizes the right of individuals to a clean and healthy environment. It is the primary legislation that provides for protection of the environment through quality standards and sets limits for the discharge of wastewater (municipal, industrial, and domestic) to water bodies (lakes, rivers, and canals) and to the sea. The law provides for the right of individuals to a clean and healthy environment and makes business and industry responsible for compliance. However, the law does not address sanitation adequately and does not provide for effective governance over operators and service providers.

203. The Water Resources Law (7/2004, 18 March 2004) stipulates the regulation of rights to use water, and specifically states that water resources are not property rights, removing the problem of regional governments claiming ownership of water sources in their regions. The rights of various groups to use water for daily basic needs of individuals and smallholder agriculture in irrigation systems are guaranteed by the Government and the regional governments. Coordination of water resources will be the responsibility of a coordinating forum (Water Resource Council). The law also provides for the possible establishment of regulatory bodies for water supply and sanitation, to be further defined in government regulations.

204. Government Regulation 16/2005, 21 March 2005, eliminates the need for local parliament approval for tariffs, clarifies the terms of private sector participation, and restates the establishment of a new regulatory body. Based on this, MPW Decree 294/2005 established the Drinking Water Systems Advisory Board (Badan Pendukung Pengembangan Sistem Penyediaan Air Minum, BPP-SPAM), which is an advisory rather than a regulatory body. Its main responsibilities include helping formulate sector policy and strategy, setting operational standards for water supply, evaluating service standards and performance of PDAMs, and making recommendations on involvement of cooperatives and the private sector in water supply.

205. While for many years PDAMs were the sole providers of water services in their region (with notable exceptions for key industrial activities), recent legislation now also provides for alternative providers.⁴⁷ Government Regulation 23/2005 on Financial Management of Public Utility Bodies (called BLU) allows regional governments to establish BLUs as not-for-profit government agencies, charged with providing public services, particularly to unserved areas. The regulation has just been enacted and it is unclear as to how this can be implemented in practice.

206. MOHA is also finalizing the Ministerial Decree on Drinking Water Tariff Policy, providing for cost recovery and a reduction in consumer categories to simplify tariff-setting mechanisms.

⁴⁶ Regulation 416/MENKES/PER/IX/1990 (Ministry of Health Regulation on Water Quality).

⁴⁷ An "alternative provider" is any non-PDAM water supply arrangement, including private companies, community systems, and vendors (tanker deliveries or water transported to households using handcarts).

207. Law 24/1992 regulates spatial planning, and Government Regulation 80/1999 the technical aspects of the KASIBA/LISIBA approach to housing and settlements on serviced sites.

5. Institutional Arrangements

208. **National Planning Development Agency (BAPPENAS).** The agency is responsible for urban and rural infrastructure planning and coordination of national reform processes, and is playing a lead role in formulating policies for water supply, sanitation, solid waste management, transport, and urban renewal. The agency is also responsible for reviewing the major sanitation issues affecting urban areas.

209. **Ministry of Public Works (MPW).** The ministry is involved in sector issues through (i) the Directorate General for Water Resources (DGWR), and (ii) the Directorate General for Human Settlements (DGHS). The ministry is responsible for all nationally funded public works and for ensuring compliance in the regions with technical standards and designs, and supports the technical development of the water, wastewater, solid waste, transport, and urban renewal (including neighborhood infrastructure, housing and shelter finance) subsectors. DGWR provides guidance in allocating surface water resources amongst users and is a key member of the Water Resource Council. DGHS has been the executing agency for numerous water supply and sanitation projects, including the multi-faceted Integrated Urban Infrastructure Development Program (IUIDP) of the 1990s. DGWR has taken the lead role for major housing and shelter initiatives of the Government, including the ongoing Loan 2073-INO Neighborhood Upgrading and Shelter Sector Project (NUSSP).

210. **State Ministry of Housing (SMH).** The ministry was formed in 2005 by the division of the former Ministry of Settlements and Regional Infrastructure (KIMPRASWIL) into MPW and SMH. The division is set out in the Presidential Decree 9/2005. In October 2005, Presidential Decree 62/2005 tasked the ministry to “operationalize” large housing projects, including the supporting physical and social infrastructure, but it is not clear how this is to be coordinated with the mandate of the MPW.

211. **Ministry of Home Affairs (MOHA).** MOHA oversees decentralization and monitoring of RG performance. It is involved in nontechnical aspects of regional companies, including sector structure and PDAMs performance, and provides guidelines for tariff setting and evaluation and monitoring of the financial and operational performance of PDAMs.

212. **Ministry of Health (MOH).** In addition to responsibility for the national health service, MOH provides guidance and support for improved public health and in the monitoring of drinking water quality standards. It provides guidance to regional governments for improving sanitation coverage, and implementing hygiene promotion programs. Through the Directorate for Environmental Sanitation, the ministry is involved in community-based water supply and sanitation, coupled with sanitation and hygiene behavioral change programs, through various donor-funded projects.

213. **Ministry of Environment (MOE).** The ministry is responsible for laws and regulations concerning all aspects of environmental protection, including water resources. The central Government enforcement agency (Bapedal) guides and supports regional agencies (provincial and city and regency levels) and supports these regional units based on need. MOE sets

wastewater discharge standards and guides monitoring and enforcement of these standards. Despite adequate legislation, weak enforcement of the prevailing regulations has resulted in many serious water quality issues.

214. Regional Government (RG). Under regional autonomy, regional governments (i.e., cities and districts) are directly responsible for sanitation services, and own, regulate, and monitor the PDAMs providing water supply; manage solid waste collection and disposal; and coordinate all transport-related infrastructure and management arrangements. Equally, they are in charge of urban renewal activities (including shelter/housing and settlement improvement). Because of limited budget allocation, sanitation systems are often poor state and lack maintenance. In many cases, regional governments do not fully appreciate the magnitude of the sanitation sector problems, and the types of solutions available to effectively and efficiently address the serious environmental problems caused by the millions of households discharging septic tank effluent and untreated grey water into the urban drainage systems or straight into rivers.

215. Regional Water Enterprises (PDAM). PDAMs are responsible for operation and management of water supply and, in many cases, delegated implementation of sanitation. Structurally, many PDAMs lack managerial autonomy from their owners, the regional governments, and policy making, regulation, and implementation have most often all been the responsibility of the PDAM. Many PDAM water supply systems have suffered from lack of maintenance, and service quality has fallen. In many instances, facilities constructed under donor-funded projects are not operating effectively. The lack of system maintenance and institutional commitment has resulted in consistently high levels of nonrevenue water.

216. Communities and Individual Households. Where PDAMs are unable to supply water, communities get their water through collective systems, or individuals organize their own facilities at the household level. In many instances, particularly in low-income areas, private water vendors obtain water from PDAMs and/or self-suppliers for distributing to households and communities. In rural areas, more than 90% of communities organize access to water supply through various forms of self-supply arrangements, which are often unreliable and time consuming. Only about 8% of rural communities are served by PDAMs, either through piped distribution systems or water transported by tankers where local enterprise systems are conveniently available.

217. Private Water Companies. The two concessions for Jakarta, another private operator in Batam, and a joint venture in Bali are the four main private sector participation (PSP) initiatives in Indonesia. A number of donor initiatives to promote PSP have not achieved favorable results, which may have contributed to a general lack of interest by foreign investors. In all cases, local consortia attempted to enter the competition, but often lacked the necessary qualifications to participate in the bidding processes and found it hard to agree suitable division of risks with local government. A few local companies are involved in concessions for water supply to industrial areas, but they do not serve nearby local communities. Some international companies have implemented water treatment plants under BOT schemes for sale of treated water to the PDAMs. Neither international nor domestic private players have expressed much interest in the operation and management of facilities in secondary cities because a suitable regulatory framework has not been established, and because of the resistance encountered from existing operators, the PDAMs, and the public at large.

218. **Private Developers.** A number of private real estate groups have expanded their operations into lower-middle-income housing. Housing estates which are being developed are marketed among middle income families. These real estate groups often team up with private banks which offer housing finance to those households which can provide evidence of stable income. There is a growing market for these private initiatives, but there are also limitations in outreach to poorer segments of society.

219. **Public and Private Banking Institutions in Housing and Mortgage Finance.** The prime public sector housing bank has been Bank Tabungan Negara (BTN), which largely caters to the needs of the large number of public sector employees. A number of private banks (like Bank Danamon) have opened housing credit lines, and even microcredit institutions (like PT Permodalan Nasional Madani)⁴⁸ have ventured into housing credit. However, the primary mortgage sector is still underdeveloped, and a secondary mortgage market⁴⁹ is only recently emerging.

6. Role of Development Partners

220. **Asian Development Bank.** ADB has financed 27 loan projects (totaling over \$2.1 billion in loan commitments) in the urban infrastructure since 1972 to date. The assistance for improving urban and rural water supply and sanitation was through eight water supply and sanitation loan projects for about \$317 million, and 15 TA projects for about \$5.9 million. Additional financing for water supply and sanitation improvement was provided through urban development projects. The programs have introduced piped water services to many medium and small size towns, financed expansion of water networks in a number of large cities, and contributed to improved WSS in rural areas. In the ten-year period from 1991, water and sanitation investments formed part of the IUIDP approach that contributed towards greater local government participation in the management of urban development and its infrastructure. A substantial portion of IUIDP loans were also directed towards WSS and urban renewal (like improvement of neighborhood infrastructure under the Kampung Improvement Program). It is estimated that WSS-related lending amounts to about 37% of total lending in urban development. ADB has also financed a total of 47 TA grant projects since 1972 to date in the sector at a total grant value of \$19.7 million.

221. Donor-funded projects have been among the main sources of investment financing in the sector, but the post-crisis lending programs for urban WSS have effectively come to a halt. While rural WSS support has restarted in 2005 with the Community Water Services and Health Project, new loan projects for urban WSS are various stages of preparation, including the Water Supply and Sanitation Project, and the Metropolitan Sanitation Management and Health Project.

222. **World Bank.** Similar to ADB, the World Bank has been involved in developing the sector under a series of water supply projects but in different parts of Indonesia such as East Java, Sulawesi, Kalimantan, Papua, and Bali. These WSS sectoral investments were then replaced by support to a number of IUIDP follow-on programs in the same provinces, again similar to ADB's experience in the sector. The Water Supply and Sanitation for Low-income Communities Project (WSSLIC-1) was introduced in 1994 for rural areas, using community-based approaches, followed by a second project (WSSLIC-2) that commenced in 2004. A third follow-

⁴⁸ Supported by ADB Loan 2072/2073-INO Neighborhood Upgrading and Shelter Sector Project (NUSSP).

⁴⁹ Supported by ADB through TA 4715-INO: Secondary Mortgage Facility.

up, called PAMSIMAS, has been negotiated with the Government. The Urban Water and Sanitation Improvement and Expansion Project (UWSIEP), which is similar to ADB's proposed WSSP in objectives and scope, has not materialized yet. The planned follow-up Urban Water Supply Project is under preparation which also deals with areas outside existing PDAM service areas, and includes a design-build-lease (DBL) concept for developing services on "greenfield" sites.

223. The World Bank cofinanced Indonesia's first IUIDP with ADB in 1987. After this, the two agencies funded about 15 years of geographically separate IUIDPs. The last IUIDPs finished in 2002 and 2003, and program development had a hiatus since the crisis and the uncertainty of decentralization. The World Bank's recent urban sector support has been either in direct response to the financial crisis, such as the highly participatory Urban Poverty Project (UPP), or specifically targeted, for example for water supply enterprises (PDAMs). Their first decentralized urban development project, the Urban Sector Development Reform Project (USDRP), of \$100 million, is much smaller than originally intended, and involves a very limited number of regional governments.

224. **United States Agency for International Development (USAID).** The Local Government Water Supply Project (LGWS) showed that access to water for the poor can be increased by supporting reforms in PDAMs and regional governments. The LGWS project developed procedures for PDAMs to achieve full cost recovery by applying transparent accounting systems. The project also supported the development of corporate plans that include provision of customer service representatives and customer satisfaction surveys. USAID also focused on supporting decentralization through its Local Government Support Program (LGSP) which provides support to regional management and urban investment planning activities.

225. Key issues in the design of the ongoing Environmental Services Project (ESP) include (i) access to clean water and sanitation services (ii) improved watershed management, and (iii) increasing the productivity of water. Child survival and reduced water borne diseases are among the main program targets, which started in January 2005. Other concerns are solid and liquid industrial wastes, and continuing with the agency's support for capacity building of and their PDAMs to deliver services.

226. **Australian Agency for International Development (AusAID).** The agency has played a key role in supporting the provision of basic water supply and sanitation in rural areas of Eastern Indonesia including Nusa Tenggara Barat and Nusa Tenggara Timur. The Government of Australia has supported the sector for the past 20 years, providing grant support for projects that focused on community empowerment, sustainability, gender and development, and the broader environment.

227. AusAID also works with the World Bank on a comprehensive framework for rural water supply and sanitation through the various WSLIC projects, including the new PAMSIMAS. Through these projects the agency has supported the Sanitation by Communities (SANIMAS)⁵⁰ approach in rural and urban areas. Lessons learned from these projects are addressed in ADB's Community Water Services and Health Project.

⁵⁰ Support to low-income communities for improved sanitation promoting self-help sanitation initiatives in rural and urban areas.

228. **German Technical Cooperation Agency (GTZ).** The German agency is working in cooperation with MOE on a number of sector issues, primarily (i) water quality surveillance in cooperation with MOH, (ii) catchment area (river basin) protection, (iii) establishing and supporting a water advisory service center working autonomously with PERPAMSI, and (iv) promoting community sanitation systems under SANIMAS—self-help programs to build wastewater collection pipelines connected to anaerobic filter reactors such as in Yogyakarta (serving about 100 families per system). In collaboration with the German Development Bank (KfW), GTZ also participated in a community-based rural water supply project in NTT, which ends in 2006. GTZ's Urban Quality Project, which closed in 2006, will be succeeded by a new program in support of local government, which is under preparation.

229. **Japan International Cooperation Agency (JICA).** The agency is supporting rural water supply projects throughout Sulawesi, serving rural neighborhoods in *20 ibu kota kecamatan* (IKK) using conventional and simple self-managed community schemes. Water resources studies are being conducted for the Jeneberang river basin in South Sulawesi, and also for Bali.

230. **Japan Bank for International Cooperation (JBIC).** JBIC has supported the water supply and sanitation sector through a number of initiatives including (i) Denpasar Sewerage Development Project (1994), (ii) Ujung Pandang Water Supply Project (1993), and (iii) Jakarta Water Supply Distributions Pipeline Project (1990). In addition to these projects, JBIC has been involved in cofinancing the Surabaya Urban Development Project with World Bank, and also the Yogyakarta Sewerage Project.

231. **Government of the Netherlands.** Netherlands is supporting an institutional development and capacity building effort in PDAMs, jointly with the World Bank Institute and Perpamsi, contributing to more efficient enterprise operation. It is also financing the Indonesia Water and Sanitation Program (WASAP-Indonesia) for Water Sector Capacity Building and Sanitation Sector Development. The trust fund of \$22 million, financed by the Netherlands, is managed by the World Bank. The Dutch Embassy is also supporting ADB's Community Water Services and Health Project through the Aceh/Nias window. The Netherlands also financed community-based initiatives under the United Nations umbrella, for instance in housing (Co-BILD project), good governance and decentralization support which also target the urban poor. The 'gaps' in this program in terms of sectors are clearly in shelter and slum upgrading.

7. Capacity and Approach to Managing for Results in the Sector

232. Problem identification seems to be working well across the various institutions involved in the sector. Numerous conferences, seminars and workshops have been held over the last 5 years, which adequately identified the main challenges and issues the sector faces. However, when it comes to concrete actions to tackle the problems, agreement on the most appropriate action plan is difficult to obtain. The fact that various ministries compete rather than work together on the sector seems to undermine the ability of the Government to come up with a unified strategic plan, and the lack of a high-level champion (outside the ministries) results in these rivalries undermining serious attempts to solve the most serious bottlenecks (such as the PDAM loan arrears).

233. Unrealistic targets set out in various policy documents, including the Medium-Term Development Plan (RPJM), include achieving drinking water quality in PDAM areas by 2008 and a toilet for each household, urban and rural, by 2009. The RPJM describes various programs to obtain these and other targets. However, costing these programs, and translating these costs into a financing plan, has not been undertaken. Data availability exacerbates the problem. PDAMs are not required to publish their balance sheets or any technical information; as a result, both their financial as well as their asset situations are unclear and leave much room for interpretation. Without a solid asset management strategy, and a transparent picture of PDAM and local government finances, determining the actual needs of the sector will be a difficult.

8. Successes and Lessons Learned by ADB in the Sector

234. ADB has contributed to improvement and expansion of water supply and sanitation services in many parts of Indonesia under earlier water supply programs, through IUIDP in Eastern Indonesia, Central Java, West Java and Sumatra, rural WSS programs, and the urban development programs in Botabek and in Metropolitan Medan. It has also supported the development of sewerage programs in Medan, and much earlier in Bandung. All these programs have been complemented by capacity development and strengthening of related institutions, including local water enterprises.

235. For the urban infrastructure sector, the main lessons from these programs and projects are the following:

- (i) Project planning and design has moved forward from almost no community participation to demand assessment surveys among potential customers in the past 15 years, principally under IUIDP. Potential productivity growth in the industrial and services sectors is predominantly urban-based, but often hampered by bottlenecks in urban infrastructure, inadequate land provision, deficient municipal services, and inadequate market information.
- (ii) The IUIDP approach may have had too short a planning horizon and too many sources of funding to be truly effective. More attention is needed to subsector specific plans.
- (iii) Promotion of integrated urban renewal can only be achieved if it is able to address infrastructure, land use, modernization of economic activities, improvement of housing and housing finance systems, and make use of partnerships between public and private sectors.
- (iv) Through the targeting of urban services, through support to micro-credit mechanisms and other avenues to promote local economic development, and through the regulatory framework of standards and permits, hawking licenses, non-motorized transport, etc. investment projects can have an important impact on the local economic opportunities of the urban poor.
- (v) Small contract packages result in inefficient procurement and increased risk of misuse of funds. The arrangements usually promote the involvement of poorly qualified contractors and often results in low construction standards.
- (vi) Poor planning and over-design has occurred in some instances, either because of poor analysis of community demand or failure to link technical design to institutional constraints.
- (vii) Small water enterprises do not have adequate technical resources to manage their own affairs or contribute strongly towards program implementation, resulting in a lack ineffective investment outcomes.

- (viii) Cooperation between regional governments for integrated management and operation of water supply (e.g., Medan and surrounding PDAMs, and Lombok Barat) promotes sector efficiencies and improved financial and technical capabilities.

236. For community-based water supply and sanitation, and settlement improvement, the main lessons can be summarized as follows:

- (i) Manageable geographic coverage of community-driven projects is important to ensure effective implementation.
- (ii) Communities need to be provided with a simple technology menu to choose from, and need to have room for experimenting with facilities that can be upgraded.
- (iii) Communities need to be involved in the whole project cycle, starting from the identification of the problems to monitoring and evaluating the implementation.
- (iv) Community contributions for construction, and full responsibility for operation and maintenance costs, along with the extensive use of qualified community facilitators leads to increased sustainability of the facilities provided.
- (v) Hygiene and sanitation behavioral change programs have to be emphasized more and implemented in parallel with construction, including extensive post-construction interventions.
- (vi) Close monitoring of construction quality and transparent project administration and procurement procedures are required.

9. Current ADB Operations and Commitments

237. **Community Water Services and Health Project (CWSHP).** The project, approved in April 2005, will provide rural water supply and sanitation facilities and services to about 1,000 communities in 20 districts in the provinces of West Kalimantan, Central Kalimantan, Jambi, and Bengkulu, combined with capacity building for districts and communities, and sanitation and hygiene behavioral change programs. An estimated 1.2 million people will benefit from safe drinking water and improved sanitation facilities. The loan-financed program for the provinces is complemented by a grant-financed component for the tsunami-affected areas in Aceh and Nias/North Sumatra, covering another 400 villages.

238. **Neighborhood Upgrading and Shelter Sector Project (NUSP).** The project, approved in 2003, supports the Government's urban poverty reduction strategy by creating sustainable mechanisms for (i) providing resources to local governments, in partnerships with communities, for site development and distribution of tenure for poor informal settlers; (ii) expanding the access of poor urban informal settlers to micro credit for shelter finance; and (iii) facilitating participatory community-driven planning by strengthening the role and capacity of participating communities, local governments, and the DGHS to meet their responsibilities. The project will contribute to establish a conducive policy, institutional, and regulatory environment to meet the housing needs of urban poor communities in informal settlements.

239. **Water Supply and Sanitation Project (WSSP).** The goal of the WSSP, scheduled for approval in 2007, is to improve the health and well-being of the urban population by equitable delivery of potable water supply and sanitation services to selected cities in response to needs in a decentralized environment, and in line with the MDG target on safe water supply and sanitation. Besides urgently needed infrastructure components the project will support a reform

process for the participating PDAMs through a financial and operational performance improvement program.

240. Private Sector Participation Development Facility for Urban Infrastructure (PSPDF). This TA loan is scheduled for approval in 2006. The project will promote PSP in urban infrastructure development on a sustainable basis by providing project preparation funding to regional governments. The PSPDF established by the project will engage consultants for PSP project preparation activities and bidding assistance, in order to address constraints to PSP activity in local infrastructure. Consulting services will be available for capacity building in the implementing agency so that it will be able to (i) select bankable PSP projects; (ii) engage appropriate consultant expertise for project preparation assistance to regional governments; (iii) draft appropriate implementing regulations; and (iv) support PSP activity through information campaigns, and liaison with investors and financiers.

241. Metropolitan Sanitation Management and Health Project (MSMHP). The project, scheduled for loan approval in 2008, will help to improve public health and to reduce environmental pollution in urban areas. The MSMHP will (i) reduce exposure of urban communities, particularly the low-income groups, from health risks associated with the discharge of raw or partially treated sewage into city drains and rivers; (ii) contribute to a significant reduction of pollution in water bodies; (iii) improve solid waste collection and treatment practices; (iv) contribute to improved local urban environments and overall reduction of environmental pollution; and (v) address serious institutional constraints affecting the sector.

242. Integrated Settlements Development Project (ISDP). The project, scheduled for loan approval in 2007, aims to accelerate pro-poor, low-income housing nationwide by providing shelter for the target group through an integrated approach of site development and services provision (KASIBA/LISIBA) and urban renewal by strengthening the primary mortgage market. The project will strengthen both the demand and supply side of the housing market to make shelter more accessible to the low-income market.

243. Second Community and Local Government Support Project (CLGS II). The project, scheduled for loan approval in 2008, will improve access of poor communities to basic and small public infrastructure (include drinking water; washing, bathing, and toilet facilities; drainage; irrigation; markets; village roads and footpaths; bridges; boat piers and harbors; schools; health posts) in urban, peri-urban, and rural areas and that will (i) increase employment and income opportunities, (ii) establish and/or strengthen community-based institutions, and (iii) improve local governments' capacity to handle community-driven development (CDD).

10. Proposed ADB Role in the Sector/Theme

244. The main justification for ADB's engagement in the urban sector will continue to be support to economic growth and urban productivity, and poverty reduction. Responding to this strategic orientation, ADB programs are proposed to cover two main agendas, i.e., city-wide infrastructure development, and urban renewal through shelter development and slum upgrading. These projects would also benefit from local currency financing, multi-tranching and the ability to make sub-sovereign loans. The issue of commitment fees is particularly sensitive when implementation times are stretched because of community consultation activities. Gradually, ADB's activities are expected to involve private sector partners in water supply and sanitation, and housing finance or housing mortgage.

11. Opportunities to Address Gender and/or Environment Concerns

245. The water and sanitation subsector, as well as urban renewal activities through shelter and settlement improvement, lend themselves to active participation of women in the communities. Women's participation shall be sought and mainstreamed in preparation, implementation, as well as operation and maintenance of subprojects.

246. Women are primarily affected by poor water supply and sanitation services because of the impact on household chores. Improving the management and operation of water supply and sanitation will include improving gender responsiveness of local agencies responsible for providing these services. Campaigns and strategies to create a demand for improved water supply and sanitation services and to promote related household investment will consider that women have a great influence on household investments.

12. Proposed ADB Activities

247. Technical Assistance

- (i) PPTA Second Community and Local Government Support Project (CLGS II), TA approved in 2005; and
- (ii) PPTA Second Neighborhood Upgrading and Shelter Sector Project (NUSSP), for approval in 2007.

248. Loan Projects

- (i) Water Supply and Sanitation Project, scheduled for approval 2008;
- (ii) Private Sector Participation Development Facility for Urban Infrastructure, scheduled for approval in 2006;
- (iii) Metropolitan Sanitation Management and Health, scheduled for approval 2009;
- (iv) Community Water Services and Health II, scheduled for approval 2009; and
- (v) Second Neighborhood Upgrading and Shelter Sector Project (NUSSP), for approval in 2009.

13. Proposed ADB Resource Contribution and Possible Partnerships, including Cofinancing Arrangements

- (i) Royal Netherlands Embassy: \$7.5 million for the PSPDF; and
- (ii) UN-Habitat: \$2.0 million for the WSSP and MSMHP.

H. Education Sector

1. Introduction

249. The purpose of this document is to describe the key issues and challenges in education, the Government's response to them, and how ADB proposes to work with the Government and other stakeholders to address these challenges in 2006-2009. The road map is based on policy dialogue and consultations held with central and local government agencies and other stakeholders throughout the previous CSP, and lessons learned from completed and ongoing ADB projects. The key government agencies for the sector are the National Development Planning Agency (BAPPENAS), the Ministry of National Education (MONE), and Ministry of Religious Affairs (MORA), the Ministry of Home Affairs (MOHA) and the Ministry of Finance (MOF).

2. Summary Situation Analysis/Constraints and Achievements

250. Indonesia's drive to improve the level and quality of education emanates from national and international factors. Within Indonesia, there are strong cultural values placed on equitable access to education. These are reflected more formally in the preamble to the 1945 National Constitution which states that one of the most important obligations of the state is to educate its people, and in the National Education law which has made 9 years basic education compulsory and free. Internationally, the government has committed to both the Education for All (EFA) and Millennium Development Goals (MDGs) and is also aggressively seeking to become a more competitive economy, with a labor force that is well educated, motivated, and highly trainable.

251. Over the past decade, Indonesia has made significant sector achievements in terms of participation. Overall enrolment at all levels of education has increased, and there has been a strong focus on equity. The primary school enrollment rate (grades 1–6) grew from 62% in 1973 to nearly universal coverage today. The gross enrollment rate for junior secondary (grades 7–9) has shown even more marked increases, rising from 18% in the 1970s to 80% in 2005. Senior secondary enrollment (grades 10–12) has been rising too, though much more modestly. These enrollment rates, especially at the primary level, compare favorably with enrollment rates in countries in East Asia with much higher incomes per capita. In higher education, though, gross enrollment rates at 13% are much lower than other ASEAN countries.⁵¹

252. Another achievement has been the diversification of partnerships in education, through the private sector and madrasah. This strong and growing public–private partnership represents a strong foundation for reforms, especially in post-basic education. The private sector represents a significant share of junior secondary provision (around 20% of places), 54% of places at the senior secondary level, and 60% in higher education. The private sector also dominates the madrasah subsector, which caters to 13% of all students in grades 1–12. Many madrasah are in rural areas, catering to poor students. Most private schools are established by benevolent foundations, but nevertheless costs to parents are higher than in comparable public general schools or public madrasah.

253. Nevertheless, disparities in access to education continue between rural and urban areas, between the rich and the poor, between children attending madrasah and those attending general schools, and between males and females. The gap between the rich and the

⁵¹ 31.9% Thailand, 29.4% Philippines and 28.3% in Malaysia.

poor is lower at the primary level than at the junior and senior secondary levels. The gender gap between girls and boys is most pronounced at the senior secondary level, but narrows to 1-2% in higher education. A 15–20% gap in access to education also exists in the secondary and higher education sectors for the rural and urban areas, mainly because of the financial costs associated with education. Only 3% of students from the lowest income quintile enroll in higher education compared with 31% from the highest income quintile. The more pronounced equity gaps at the senior secondary and higher education levels are due partly to the dominance of private sector institutions, which must operate on a cost-recovery basis even if they are nonprofit.

254. The quality of education (commonly measured in terms of students' education outcomes) is determined by a complex set of within school and outside school factors. In the 2005 National exam, 13% of secondary high school, 22% of vocational high school and 21% of senior high school students did not pass (passing score was 42%), although there was a marked improvement in the average scores of those that did pass. Education quality is also low in the higher education sector, with only four higher education institutions ranking among the top multidisciplinary universities in Asia. In addition, Indonesia needs better-prepared teachers, and better allocation of teaching assignments according to expertise and interest.

255. Despite inevitable teething troubles, the education system has responded significantly to broader decentralization reforms. Government recognizes the urgency of addressing some key access and quality constraints. Achieving the MDGs requires getting the last 10% and 25% of primary and junior secondary-aged children, respectively, into school, which has proved more difficult than envisaged. Key factors include substantial cost barriers, uneven coverage of facilities and the limited outreach of nonformal education and distance-learning programs. A related factor is the limited response of the private sector in poorer rural areas.

256. Government is acutely aware of the need to raise nationwide education standards. Education financing strategies need to be better aligned with sector and decentralization policies. Channelling more funds through local governments, alongside improved accounting and audit procedures will better enable decentralization reforms.

3. Key Development Issues and Challenges

a. Addressing Key Macroeconomic Challenges

257. Indonesia is ranked in the bottom third of the global economic competitiveness index⁵². A quarter of Indonesian firms consider inadequate workforce skills as a key obstacle to their profitability and competitiveness.⁵³ The absence of a workforce capable of enabling economic transition to higher technology, value added, jobs has been identified as a key constraint, alongside insufficiently flexible labor market policies and business start-up procedures.^{54,55} Key constraints include an inadequate supply of well-educated, trainable, and motivated secondary and higher education graduates and comparatively low levels of workers skills upgrading by firms.⁵⁶ Measures to ensure improved work force productivity are critical for attracting domestic

⁵² World Economic Forum Index, 2003. Malaysia and Thailand ranked in the top third.

⁵³ Decentralized Senior Secondary Education PPTA, ADB 2005.

⁵⁴ World Bank Doing Business Survey, 2005.

⁵⁵ ADB-World Bank Private Investment Climate Survey, 2003/04.

⁵⁶ ADB-World Bank Investment Climate Survey. Only 23% of firms offer formal training to employees, compared to 69% in the People's Republic of China and 42% in Malaysia.

and foreign investment and optimizing the economic impact of the projected expanded urban and rural infrastructure programs.

258. Unemployment in Indonesia is high (9.5% in 2003) compared with regional neighbors and competitors such as the Republic of Korea (3.7%), Thailand (1.5%), and Malaysia (3.4%). About 30 million people, mainly in rural areas, are underemployed. Around one third of 15–24-year olds in the labor force are unemployed. Young people make up almost two thirds of the unemployed. The past 3 years have seen a loss of almost 1 million formal sector jobs, only partly offset by a growth in informal sector employment. Since 2000, around 85% of all job losses were in rural areas. 70% of all paid jobs are in urban areas, which constitute only 40% of the labor market population.⁵⁷ The absence of secondary and higher education and training opportunities in rural areas is recognized as a key constraint in generating off-farm paid employment.

259. Since 1997 most job creation has been in the informal sector and through SMEs. Job creation is stagnant in trade, manufacturing, and services, with agriculture showing significant growth.⁵⁸ The shortage of high-quality secondary and higher education graduates and inadequate business education programs in schools and universities is a key factor in rural SME development.^{59,60,61} Overcoming these constraints will be critical if Indonesia is to respond to labor market mobility and trade liberalization within the ASEAN Free Trade Area (AFTA).

b. Addressing Key Sector Challenges

260. The Government recognizes the urgency of strengthening the foundation of the education system, by addressing key access and quality constraints. Achieving the MDGs requires getting the last 10% and 25% of primary and junior secondary aged children, respectively, into school, which has proved more difficult than envisaged. It also means ensuring that all children complete at least primary education. Key constraints to achievement of universal basic education include substantial cost barriers, uneven coverage of facilities and the limited outreach of nonformal education and distance-learning programs. A related factor is the limited response of the private sector in poorer rural areas. Massive disparities in per-student spending across districts are a further constraint on ensuring equitable access to high quality education. The large stock of primary schools built in the 1970s needs rehabilitation, while rehabilitation and expansion is needed at the junior secondary level. Government is also acutely aware of the need to raise nationwide education standards, through improved qualifications of teachers as well as the provision of adequate textbooks and other learning materials.

261. While more resources are needed to achieve EFA and the MDGs, there is an acute need to reform the structure and strategies for education financing. Education financing strategies need to be better aligned with sector and decentralization policies. Channeling more funds through local governments, alongside improved accounting and audit procedures will better enable decentralization reforms, as well as address access and quality issues at the district and school levels. Recognizing the importance of social factors on educational

⁵⁷ Central Bureau of Statistics – BPS.

⁵⁸ From BPS annual SAKERNAS (National Labour Force Surveys).

⁵⁹ World Bank Policy Brief: Supporting Small and Medium-Sized Enterprises. 68% of all SMEs located in Java alone.

⁶⁰ International Association for Evaluation of Education Achievement, 2003. For 14 year olds Indonesia ranked 35 out of 39 in maths and 33 in science.

⁶¹ OECD survey 2003 for 15 year olds. Indonesia ranked 39 in reading and mathematics and 38 out of 41 countries in science.

attainment, the Government is seeking a more formal role for parents and communities in supporting schools and learning outcomes at home.

262. The Government is aware of the need to improve the efficiency and effectiveness of public resources at the higher education level. Its strategy is to build on the reforms in higher education over the last decade with ADB and World Bank assistance, by increasing the proportion of funds provided to higher education institutions through competitive grants. This strategy is expected to motivate higher education institutions to improve quality, efficiency, and relevance of education in order to develop a productive and competitive workforce, for the formal and nonformal markets as well as SMEs.

4. Government Policy and Planning Framework

a. Medium-Term National Development Strategy 2004–2009

263. Education and training reforms need to enable implementation of the Government's Medium-Term Development Plan for 2005–2009, which is characterized by a strong focus on policy and institutional reform and active involvement of the private sector in infrastructure development for service delivery. Policies and programs to ensure social justice, equity, and the quality of basic social services are a central pillar of the plan.

264. The Government has identified five priority areas to achieve the growth necessary to support its policies and programs: (i) adopting job creation and poverty reduction programs; (ii) maintaining macroeconomic stability through stable prices, fiscal sustainability, and financial sector reforms; (iii) accelerating the growth of investments, exports, and tourism through reforms to create a healthy business climate and flexible markets; (iv) improving human resources; and (v) developing infrastructure by improving the efficiency of services and encouraging greater private sector participation.

265. The plan recognizes that institution building within central and local government and sector agencies, especially to enhance participation and accountability, is critical. Within the education and training sector, measures to strengthen institutional responsiveness to labor market and economic conditions will be essential. The strength of this response would be optimized by parallel measures to improve labor market flexibility and job creation through wage and employment regulatory reforms.

b. Education Strategic Priorities

266. Under the new minister of national education, MONE has developed the Education Strategic Plan (ESP) 2005–2009. Major priorities include (i) achieving universal access to 9 years of basic education by 2009,⁶² (ii) expanding net enrolment rates in senior secondary and higher education,⁶³ (iii) raising education standards and relevance at all levels, including efficient teacher preparation and deployment, (iv) strengthening results oriented education governance and management systems, especially at district and school/institutional levels and (v) improved results orientation of sector planning and monitoring systems. Other features consist of (i) better harmonization of public/private partnerships, (ii) ensuring graduates are increasingly regionally

⁶² ESP 2005-2009 draft projects net enrollment rate in primary education rising from 92% to 100%, junior secondary from 62% to 100%, by 2009.

⁶³ ESP 2005-2009 draft projects net enrolment in general/technical senior secondary education rising from 38% to 70% by 2009, higher education from indicative 12%-14% to 18%, by 2009.

and internationally competitive, (iii) stimulating a more demand side response to program implementation and (iv) strengthening quality assurance and monitoring systems, particularly school/community and district/local government accountability mechanisms.

267. Apart from the successes in raising participation, the Government has also made good progress toward achieving some of these other objectives. In accordance with the National Education Law (20/2003), two independent agencies were established recently—the National Board of Education Standards and the National Accreditation Agency—to raise education standards and ensure better quality assurance. Ministerial decrees and regulations on minimum service standards for districts and national education standards for schools have also been developed. As a first step of a broader reorganization plan, MONE has established a new Directorate General of Teacher Education to tackle persistent issues of low teacher quality.⁶⁴ The objective of the proposed reorganization is to better align MONE organizational structures with the increased responsibility for policy development, strategic guidance, standards setting and performance monitoring. Similar reorganizations are anticipated at the provincial and district levels to achieve better alignment with provincial responsibilities for operational monitoring and technical support, and district level responsibilities for strategic and operational management and medium-term financial planning and management.

268. The public–private partnership in the education sector has been given prominence in the National Education Law, with equal treatment of public and private schools in terms of financing.⁶⁵

269. The ESP 2005-2009 makes a serious effort to set targets for many of the reforms identified, many of which are time-bound and measurable. Monitoring progress will be hampered, however, by the deficiencies in the national education management information system, which has virtually collapsed since decentralization.

c. Education Financing: Strategy and Outlook

270. Some far-reaching financing strategy and management reforms are incorporated into the ESP 2005-2009: (i) immediate abolition of direct costs to parents in basic education,⁶⁶ (ii) increased school grant allocations to offset parental contributions, under the “BOS” program,⁶⁷ (iii) channeling more resources through education block grant transfers to local Governments through a transitional matching grant program, (iv) more results-oriented and demand-driven school infrastructure programs and (v) development of demand led capacity development funds at central, provincial and district levels.⁶⁸

271. The ESP 2005-2009 financing strategy incorporates continued fee paying at senior secondary and higher education levels and Government-supported merit-driven scholarships for poor students. The strategy also projects extensive assistance to capacity development, including central and provincial sector performance monitoring and audit systems, district

⁶⁴ Reorganization of the Office of the Secretary General was completed in mid-2005, incorporating the existing Unit for Facilitation of Decentralized Education (UFDP), currently supported by ADB.

⁶⁵ It should be noted that the private schools primarily serve the poor, established originally to absorb the overflow from the public system.

⁶⁶ Approved by National Parliament in May 2005.

⁶⁷ An additional allocation of Rp11 trillion to the central MONE budget, approved for budget years 2005/2006, with agreed increases to around Rp65 trillion by 2009.

⁶⁸ Similar to the capacity development funds under the ADB-supported Sustainable Capacity Building for Decentralization Project.

financial planning and management systems development and improved school accounting practices.⁶⁹

272. In contrast to earlier plans, the ESP makes a serious effort to link the reforms planned by costing the reforms to establish the financing needs, identifying the funds expected to be available, and the funding shortfalls. Targeted budgets are also presented for subsectors and activities such as capacity development.

5. Institutional Arrangements

273. The ESP 2005-2009 is built on the legal obligations of the state as outlined in the 4th Amendment to Article 31 on Education; Law 17/2003 on State Finance; Law 20/2003 on the National Education System; Law 25/2004 on the National Development Planning System; Law 32/2004 on Local Government; Law 33/2004 on the Fiscal Balance between Central and Local Governments; and Law 15/2005 on Teachers and Lecturers.

274. These laws are operationalized through the issuance of Ministerial Decrees and Government Regulations. To implement Law 20/2003 on the National Education System, a Regulation on National Standards of Education was passed in 2005. Two more regulations are planned for 2006, on education financing and education management. A task force has been established by the Minister of Education to develop the National Standards of Education⁷⁰, which has completed standards for two of the eight areas specified. The most recent law passed for education was the Law on Teachers and Lecturers, which specifies more stringent requirements for teacher training and qualifications.

275. While these laws have established the legal framework for the right of Indonesians to at least 9 years of basic education, there continue to be numerous inconsistencies and gaps within the legal framework governing the decentralization of education. This has led to ambiguities about the role and responsibilities of various government levels and stakeholders in achieving education objectives. MOHA is leading a process to resolve some key inconsistencies related to the obligations of different levels of government in consultation with local governments and line ministries.

276. Community support has traditionally been strong for public and private education sector through the provision of financial and other resources. The community's role of managing schools has been formalized by adopting a school-based management approach, in which the community has a key role in developing a school development plan and in determining the use of block grants to schools according to specific local needs.

277. Key institutions in the education sector include MONE, which oversees the general education system, and MORA, which manages the madrasah. All programs from early childhood education, to primary, junior secondary, senior secondary, and tertiary education are offered by public and private schools under MONE and MORA. Both ministries work closely with BAPPENAS for planning and with the MOF for financing, using the Government's own resources as well as those of international development partners. Law 20/2003 on the National

⁶⁹ Draft ESP, May 2005 includes an allocation of over Rp2 trillion per annum for the plan period.

⁷⁰ Standards will be developed for (i) graduate competence (knowledge, attitude and skills), (ii) Education content, (iii) education process, (iv) teachers and education staff qualifications, (v) facilities and infrastructure, (vi) education finance, (vii) management, and (viii) education evaluation.

Education System mandates a unified system of education covering public and private, and religious and secular (general) schools and universities, but historical precedent and current politics has resulted in the continuation of the two separate agencies.

278. The decentralization of education in 2001 has placed considerable stress on service delivery. While the delegation of service delivery to the district governments has the potential to improve efficiency, the central and local governments have varying degrees of capabilities to implement the various tasks that come with decentralization. Although the lack of legal clarification makes institutional restructuring complex, the central Government certainly needs to build its human resources to assume new tasks of developing and analyzing policies, establishing standards, and monitoring development outcomes. The district governments, however, need to develop the capacity to plan and implement programs, manage resources and identify and disseminate innovative practices that work within the system.

6. Role of Development Partners

279. A number of development partners have been actively supporting MONE and MORA, including ADB. Since 1975, ADB has financed 31 education and training projects for a total of \$2,217 million, and has provided about \$16 million in grants for 36 technical assistance (TA) projects. ADB focused initially on technical and/or vocational and higher education, but expanded its support in the 1990s to include basic education, in line with Government policy to achieve universal basic education (UBE) of 9 years. AusAID has been supporting basic education as well as higher education through long-term academic scholarships, along with CIDA, and USAID. JICA, UNCIEF, UNESCO, and NZAID support basic education while GTZ has been developing the quality of science education. The World Bank is supporting early childhood education, basic education, and in 2005 approved a loan to improve the relevance and efficiency of higher education.

280. Development partners coordinate through the Education Sector Working Group (ESWG), which provides an informal forum for discussion on key issues. Key government agencies such as MOF, BAPPENAS, MONE, and MORA have initiated participation in the ESWG. The EC has recently proposed the formation of a high-level policy forum for the sector, the terms of reference and composition of which are under discussion in the ESWG.

7. Capacity and Approach to Managing for Results in the Sector

281. The ESP 2005–2009 is a well-written document that is based on a good problem and issues analysis, addresses three key areas of education development: (i) access and equity, (ii) quality and relevance and competitiveness, and (iii) governance and management. It outlines clearly the monitoring and evaluation responsibilities at different levels of government and the community. The strategy is results-oriented and had clear targets for outcomes for the above three areas for 2004–2006. However, with decentralization, the education system's capacity to collect and analyze data has been dissipated, and districts feel less compelled to share information with the national Government. In 2000, the annual school census yielded an 80% response rate, but this has since declined significantly. This may partly be a result of the weak district capacity for data collection, and even weaker capacity for data analysis. While districts have an obligation to share data on national education outcomes with MONE and MORA for the allocation of resources, they also need data for better local management. DBEP (Loan 1863-INO) is working with five district education offices to assist them with this type of capacity building. The EU plans to strengthen the national education management information system under new grant assistance.

8. Successes and Lessons Learned by ADB in the Sector

282. ADB has been a lead donor in education. ADB has provided \$2,127 million in loans for 31 projects and \$16 million in grants for 36 TA projects. Over the past decade, strategic priorities have been to enable more equitable access to high-quality basic and higher education through public-private partnerships. In the case of higher education, the focus has been on technological and workforce skill development. In response to decentralization policy a cross-cutting priority has been more decentralized education management, especially at district and school levels. Lessons learned from these ADB and other donor initiatives, especially related to public private partnership and decentralized management, have helped inform and forward MONE decentralization strategies.⁷¹

283. ADB has led in supporting development of the private and religious secondary education, especially harmonizing curriculum and teacher development and financing strategies within national systems.⁷² A number of projects have improved responsiveness of senior secondary and higher education institutions to labor market requirements.⁷³ ADB support for mitigating the risks to education during the 1997 crisis helped inform broader policy and institutional reform, including development of pro-poor and decentralized financing strategies.⁷⁴ A comprehensive program of education sector work and advisory TA has contributed significantly to policy and strategy development, including the ESP 2005-2009 process.

284. Key lessons learned⁷⁵ include (i) the importance of community and private sector participation in the design, implementation, and monitoring of programs; (ii) the importance of demand-driven and performance-based approaches; (iii) the need for a greater focus on institution building and capacity development at local government and school levels; (iv) mainstreaming results-oriented implementation, planning, and monitoring systems; and (v) a stronger focus on the sustainability of project inputs.⁷⁶ It is recognized that the impact of policy dialogue between the Government, ADB, and other donors has been limited by the uncertain political and policy environment and the absence of a jointly agreed and Government-led set of sector strategy priorities and performance monitoring framework. Coordination between projects executed by education agencies and other Government bodies may have been less than optimal⁷⁷. Uncertain financial and institutional sustainability of some education projects has been a concern. It is acknowledged that ADB assistance needs to be more results-oriented,

⁷¹ ADB. 2001. *Report and Recommendation of the President to the Board of Directors for the Decentralized Basic Education*. Manila. Loan 1863, approved on 29 November 2001 for the amount of \$100 million.

⁷² ADB. 2005. *Report and Recommendation of the President to the Board of Directors for the Private Junior Secondary Project*. Manila. Loan 1359, approved on 18 July 2005 for the amount of \$49 million. ADB. 1996. *Report and Recommendation of the President to the Board of Directors for the Basic Education Project*. Manila. Loan 1442, approved on 6 June 1996 for the amount of \$85 million. ADB. 1997. *Report and Recommendation of the President to the Board of Directors for the Development of Madrasah Aliyah Project*. Manila. Loan 1519, approved on 25 March 1997 for the amount of \$85 million.

⁷³ ADB. 1995. *Report and Recommendation of the President to the Board of Directors for the Senior Secondary Education Project*. Manila. Loan 1360, approved on 18 July 1995 for the amount of \$110 million. ADB. 2000. *Report and Recommendation of the President to the Board of Directors for the Technological and Professional Skills Development*. Manila. Loan 1792, approved on 29 November 2000 for the amount of \$80 million.

⁷⁴ ADB. 1998. *Report and Recommendation of the President to the Board of Directors for the Social Protection Sector Development Program*. Manila. Loan 1622/1623, approved on 9 July 1998 for the amount of \$150 million.

⁷⁵ ADB PPARs for Junior Secondary and Higher Education Projects.

⁷⁶ Country Assistance Program Evaluation for Indonesia. 2005.

⁷⁷ One example is limited strategic linkage between ADB support for SMEs (under MOF) and a number of other skills development programs under MONE.

focused more strongly at national and sector levels, and be underpinned by stronger poverty, governance, capacity development, and private sector assessments, and greater selectivity of anticipated outcomes and thematic approaches.⁷⁸

9. Current ADB Operations and Commitments

285. Loan 1863-INO⁷⁹ grant cofinancing by the Dutch Government for \$28 million. The project supports the implementation of decentralized basic education in Bali, West Nusa Tenggara and East Nusa Tenggara, and has been designed to improve poor children's participation in and completion of compulsory 9-year basic education through (i) school development, which comprises capacity development of local communities and school staff around the school-based management concept, reflected in school development plans that are in turn supported by the school development fund; (ii) district basic education development, which aims to develop the capacity of districts to plan and manage decentralized basic education as reflected in a 5-year district education development plan and improve the quality of education using the District Education Development Fund; and (iii) monitoring, evaluation, and reporting on the progress of (i) and (ii), through program and financial compliance monitoring, and also by examining the impacts of decentralization on basic education service delivery. Expected outcomes include the introduction of school-based management in about 4,000 schools, the implementation of minimum service standards in 26 districts, and the development and implementation of district education development plans in all project districts.

286. The overall purpose of TA 4391-INO: Support to Decentralized Basic Education Management II⁸⁰ is to enhance national capacity to plan, manage, and deliver basic education services that meet minimum service standards, through (i) improved design and implementation of cost-efficient strategies and priority programs to achieve equitable access, quality improvement at central and district levels; (ii) improved knowledge management strategies for the identification, advocacy, dissemination and use of sustainable and high-impact good practices, especially at district and school levels; and (iii) strengthened partnership arrangements for the planning, management, and financing of capacity development programs at central, provincial, district, and school levels.

287. Expected outcomes will include (i) revised and approved Education Strategic Plan (ESP) 2006–2010 and strategic guidelines issued by MONE; (ii) 5-year operational strategies and plans prepared and implemented in increasing numbers of districts; (iii) inventory of evidence-based good practice and dissemination strategy; (iv) good practices used in increasing numbers of districts and schools; (v) sector-wide capacity development strategy and plan with performance indicators; and (vi) design and implementation of central, provincial, and district capacity development fund (CDF) mechanism and cofinancing arrangements.

288. Loan 1792-INO: Technological and Professional Skills Development Project⁸¹ aims to improve international competitiveness and help achieve sustainable economic growth to reduce

⁷⁸ ADB CSP Update 2005.

⁷⁹ ADB. 2001. *Report and Recommendation of the President to the Board of Directors for the Decentralized Basic Education*. Manila. Loan 1863, approved on 29 November 2001 for the amount of \$100 million.

⁸⁰ ADB. 2004. *Technical Assistance to Republic of Indonesia for Support to Decentralized Basic Education Management II*. Manila. TA 4391, approved on 14 September 2004 for the amount of \$500,000 and cofinanced by the European Union for \$6,030,000.

⁸¹ ADB. 2000. *Report and Recommendation of the President to the Board of Directors for the Technological and Professional Skills Development*. Manila. Loan 1792, approved on 29 November 2000 for the amount of \$80 million.

poverty, on the basis of gender, social, and geographical equity. It has two interrelated parts: (i) strengthening the governance and management capacity of the public and private higher education system, improving student equity, supporting a retraining program and supporting project implementation; and (ii) strengthening existing and supporting new study programs in the top priority disciplines in higher education, upgrading study centers for women and strengthening community and industrial relations. The expected outcomes are improved accreditation levels for project institutions, improved graduate quality, reduced length of study, improved English proficiency, and reduced waiting times for graduate employment.

289. Grant 0002-INO: Earthquake and Tsunami Emergency Support Project⁸² (ADB \$13 grant for education component, \$10 million reprogrammed from Loan 1863-INO), will help rebuild education quality in Aceh and Nias at the senior secondary level, by supporting the provision of teaching and learning materials to 200 schools, and the provisions of specialized computer and science laboratories to around 60 senior schools. Around 50 basic education schools in Simelue will be reconstructed using the reprogrammed DBEP funds.

10. Proposed ADB Role in Education

a. Supporting Universal Basic Education

290. ADB will extend its targeted support to public/private madrasah, currently in demand from mainly poor families who want a combination of mainstream and religious education. The focus will be upon quality improvement and mainstreaming of madrasah. Demand for madrasah education is high and there are reasonably reliable social and private returns. ADB has extensive previous experience in this subsector. As it is mostly private, this support will continue to build upon ADB's previous work in strengthening private-public partnerships. The most appropriate modality is a traditional project investment, providing infrastructure support and school block grants.

b. Enabling a Market Responsive Post-Basic Education and Skills Training

291. To improve the competitiveness of the labor force, ADB will strengthen post-basic education by promoting greater market responsiveness. To ensure high school graduates are more regionally competitive, selected senior secondary schools will be brought up to regional standards, through a project modality.

292. Support to improving the quality of university programs is proposed to continue in a follow-on project to the current technological and professional skills development project, to better meet the demands of the labor market. This project will promote quality improvements, including upgrading of infrastructure, including the strengthening and expansion of polytechnic programs, using a system of competitive block grants. This approach was pioneered by ADB to promote quality improvement and governance development policies. Increased block grant funding is being used as part of the phasing in a system of autonomous higher education institutions. The overarching longer-term priority in higher education is to redefine the role of Government as an enabler, not a dominant provider, of a more market-responsive post-basic education and skills training system.

⁸² ADB. 2005. *Report and Recommendation of the President to the Board of Directors for the Earthquake and Tsunami Emergency Support Project*. Manila. Grant 0002, approved on 7 April 2005 for the amount of \$290 million.

c. Supporting the Ongoing Reform Process

293. **Basic Education Capacity Development.** The decentralization of education services poses new challenges. These include establishing clear roles, appropriate governance structures, and financing arrangements at all levels of government; reforming the structure and processes of MONE; increasing education resources for district and city governments; and building capacity to deliver effective decentralized services. ADB has helped MONE formulate policy and strategies for district education financing, governance and minimum service standards through TA support, in addition to supporting the development of the ESP. ADB support for capacity development and decentralization will continue under TA 4391-INO.⁸³

294. **Policy Development for Post-Basic Education.** The ongoing education reform process provides an opportunity for ADB to take a lead in facilitating sector-wide institutional and governance reform policies at the senior secondary and post-secondary levels, which are underdeveloped. Measures that improve participation, transparency and accountability of post-basic education services, will support the development of improved market responsiveness.

295. The new ESP provides an opportunity for ADB and other development partners to support a far-reaching education reform program, possibly as part of a sector-wide approach that would propose an expansion of governance, quality assurance, and anticorruption monitoring.

11. Proposed Sector Outcomes and Outputs to be Supported by ADB

296. Table A6.1 shows the education sector targets for the CSP. The sector outcomes are derived from government policy and strategy documents. Those selected are the most relevant for the ongoing and planned ADB education program. As the output indicators are derived from ongoing and planned ADB activities, they represent the contribution that ADB can make to the overall sector outcomes.

12. Opportunities to Address Gender and/or Environment Concerns

297. Both MONE and MORA are acutely aware of the need for and are committed to addressing gender in all its dimensions. The ESP 2005–2009 examines gender disparities at all levels of education and, while disparities in terms of education access and attainment are not as severe as other countries in Asia, these nonetheless need to be narrowed in keeping with equal rights outlined for all citizens under Indonesia's Constitution, and other international commitments it has signed such as the Convention on the Elimination of All Forms of Discrimination Against Women. In ADB's assessment, while the government is committed to addressing gender issues, it attributes these to social and cultural practices which it perceives as difficult to change. ADB has opportunities for addressing gender issues in its ongoing operations in the education sector by developing simple and realistic gender action plans and by ensuring MONE and MORA take the lead in this initiative.

⁸³ ADB. 2004. *Technical Assistance to Republic of Indonesia for Support to Decentralized Basic Education Management II*. Manila. TA 4391, approved on 14 September 2004 for the amount of \$500,000 and cofinanced by the European Union for \$6,030,000.

13. Proposed ADB Activities

298. The activities proposed consist of a firm loan for madrasah education for 2006, a tentative loan in senior secondary education for 2007, a proposed ADTA on policy and strategy development for post-basic education for 2007, and a proposed follow-on higher education loan for 2009 (discussed with MONE but not yet with BAPPENAS).

- (i) **Madrasah Education Development Project.** The project will promote closer integration of public and private madrasah at all levels into the national education system, and improve the quality, equity, governance and management of madrasah. The project will result in improved madrasah education quality through better teaching and learning resources and better trained teachers; improved social equity; improved madrasah management and financial sustainability by reducing financing gaps between MONE schools and madrasah and introducing transparent financial management and establishing school committees. The project is scheduled for approval in 2006, for around \$50 million.
- (ii) **Second Senior Secondary Education Project.** The project will support the establishment of high-performing senior secondary schools in the general academic and vocational and technical streams. The outcome of the project will be high-quality graduates well prepared to continue to higher education, and skilled workers with training relevant for employment in high-growth sectors of the economy. The project will deliver improved learning outcomes, improved school management and quality assurance, improved equity in senior secondary education and better policy development and planning. Strong linkage arrangements with the private sector will be a lynch pin of the project. The project is planned for approval in 2007.
- (iii) **Poverty Reduction and MDG Acceleration (Policy Loan).** This program will continue ADB's support to the Government for acceleration of MDGs in basic education. It seeks to strike a balance among the following three objectives: (a) the immediate need of meeting the MDGs through budget support for sectoral programs, (b) strengthening the policy reform agenda being undertaken by the government in terms of performance based and pro-poor resource allocation within a decentralized environment, and (c) strengthening district government ability to better manage their obligatory functions for basic education service delivery according to the minimum service standards being developed. The basic education sector policy matrix outlines key areas of reforms that the government has initiated and which ADB may support to meet the above objectives.

Table A4.10: Sector Road Map Results Framework for 2006–2009

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators	Milestone (Tracking) Indicators	Interventions
Increased enrolment and retention of poor/rural students (in select districts) in basic education, and women and poorer students in post-basic education	<ul style="list-style-type: none"> Disparities in provision of basic education between rural and urban area Basic education costs are a barrier to poorer families participating in education especially at junior secondary level. Cost barriers are a constraint to equal access to post-basic education. Higher Education concentrated in a small number of urban provinces 	<ul style="list-style-type: none"> 95% of children complete basic education by 2009 Improved transition rates from primary to junior secondary and enrolments in junior secondary education increase Participation of women in priority disciplines in top universities increases by 50%. Participation of poor students in priority university disciplines increases by 20,000. 	<ul style="list-style-type: none"> Annual education statistics data 	<ul style="list-style-type: none"> Decentralized Basic Education Project Madrasah Education Development Project Technical and Professional Skills Sector Development Project Basic Education Project (AusAID) Higher Education Development Project (World Bank)
Restored access to basic and secondary education in Aceh and Nias	<ul style="list-style-type: none"> Slow implementation of reconstruction programs Complex decision-making process with new implementation arrangements. 	<ul style="list-style-type: none"> 50 basic education schools reconstructed in Simelue. 200 secondary schools with upgraded facilities and teaching /learning materials 	<ul style="list-style-type: none"> ETESP progress reports. Annual provincial education statistics 	<ul style="list-style-type: none"> Earthquake and Tsunami Emergency Support Project. Many other donor projects
Quality, Relevance and Competitiveness				
Better learning outcomes for poor students	<ul style="list-style-type: none"> Disparities in student performance between urban and rural areas Poor teacher quality in rural and remote areas 	<ul style="list-style-type: none"> 80% of grade 9 students in general schools pass the national exams by 2008. 	<ul style="list-style-type: none"> Annual data from Examinations Council 	<ul style="list-style-type: none"> Decentralized Basic Education Project Senior Secondary Education Project Madrasah Education Development Project Basic Education Project (AusAID) Decentralized Education Project (USAID)

Table A4.10 – Continued

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators	Milestone (Tracking) Indicators	Interventions
Increased relevance and competitiveness of graduates from basic, secondary and higher education, including madrasah education	<ul style="list-style-type: none"> Lack of market competitiveness of graduates in national and regional labour markets Quality of madrasah education poor, especially teacher quality and facilities, 	<ul style="list-style-type: none"> Around 100 selected senior secondary schools begin process of upgrading to international standard. Madrasah teachers and facilities in 23 districts are in process of upgrading. Priority fields of study in public universities strengthened. 	Quarterly reports from MEDP, DSSE and TPSDP	<ul style="list-style-type: none"> Senior Secondary Education Project Technical and Professional Skills Development Project Madrasah Education Development Project MEDP Learning Assistance Program for Islamic Schools. (AusAID) Basic Education Project (AusAID)
Governance, Accountability and Public Image				
Strengthened management of decentralised education services	<ul style="list-style-type: none"> Poor capacity of district governments to plan, manage, and monitor education service performance improvements, including financing arrangements The organization of central and district functions and responsibilities is not well aligned with the needs for effective sector planning and management 	<ul style="list-style-type: none"> District education development plans and financing strategies. Districts produce sector performance reports Increased central MONE capacity to manage sector review processes, including coordination of sector-wide policy, strategic planning and financing 	Multi-year capacity development plans developed. Action plan for implementing MSS-related target setting and district performance ratings,	<ul style="list-style-type: none"> Decentralized Basic Education Project Support for Decentralized Education Management II Madrasah Education Development Project Basic Education Project (AusAID)

Table A4.10 – Continued

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators	Milestone (Tracking) Indicators	Interventions
Expansion and Equity				
Strengthened school/community governance and improved school-based management	<ul style="list-style-type: none"> Greater community participation needed in schools and madrasah to encourage transparency and accountability, and improve quality and relevance School-and institution based planning, management and monitoring remains weak. 	<ul style="list-style-type: none"> 70% of DBEP school and 50% of MEDP madrasah have school committees that meet monthly 95% of DBEP schools and 95% of MEDP madrasah have a school development plan. Selected public universities have strong governance and management, and meet the criteria for autonomous status 	Quarterly project progress report and independent evaluation reports from DBEP, MEDP, TPSDP.	<ul style="list-style-type: none"> Decentralized Basic Education Project Madrasah Education Development Project Technical and Professional Skills Development Project Learning Assistance Program for Islamic Schools. (AusAID) Decentralized Basic Education (USAID) Higher Education Development Project (World Bank)

BEP = Basic Education Project (AUSAID), DBE = Decentralized Basic Education (USAID), DBEP = Loan 1863-INO: Decentralized Basic Education Project (2002–2008), ETESP = Grant 0002-INO: Earthquake and Tsunami Emergency Support Project, HEDP = Higher Education Development Project (World Bank), LAPIS = Learning Assistance Program for Islamic Schools (AusAID), MEDP = Madrasah Education Development Project, SDEM II I= ADTA 4391-INO: Support to Decentralized Education Management II (2003–2008), SSSE = Second Senior Secondary Education Project, TPSDP = Loan 1792-INO: Technological and Professional Skills Development Project (2001–2007).

Source: Asian Development Bank

I. Health Sector

1. Introduction

299. The purpose of this document is to describe the key issues and challenges in the health sector, the Government's response to these challenges and how ADB proposes to work with the Government and other stakeholders to address these challenges in 2006–2009.

300. The road map was developed using secondary data and reviews of the health care situation, and from first-hand knowledge of the situation in the country. At the point of its preparation, no consultation has taken place between the sector specialist of ADB and the relevant Government ministries and agencies.

2. Summary Situation Analysis

301. Health outcome improved significantly in 1970–1990. In the 1970s, the Government supported investment to improve access to basic health care, as new health centers and sub-health centers were built, and medical and paramedical staff placed closer to communities. In parallel, an effective family planning program was instituted, and public health programs accelerated. In the 1980s, with robust economic growth, resources in health care grew, with additional investments made in the health sector.

302. The country may not meet all health-related MDGs. Since the Asian crisis of 1990s, improvement in health outcomes has slowed down significantly as a result of falling household incomes, rising health expenditures, and reduced public sector resources for health. Relative to countries of similar income in the East Asia and Southeast Asia, Indonesia reports higher maternal mortality, higher prevalence of child malnutrition, and higher incidence of tuberculosis among adults. Over the past decade, infant mortality rate (IMR) per 1,000 live births halved from 60 in 1990 to 35 in 2002, and remains at an average level for the East and South East Asia region. However, women's health status is still among the worst in the region. In 2000, maternal mortality ratio (MMR) was 307 deaths per 100,000 live births, much above the regional average. The international community is concerned that Indonesia may not meet all the health-related MDGs.

Table A4.11: Indonesia, Relevant Health-Related Millennium Development Goals^a

Relevant Goal for Health	Baseline			Progress Status	Goal 2015
	1988–1992	1993–1997	1998–2002		
Maternal Mortality Ratio (per 100,000 live births)	—	334	307	Improving slowly	90
Child Mortality Rate (per 1,000 live births)	91	—	45	On track	30
Infant Mortality Rate (per 1,000 live births)	60	46	35	On track	20
Underweight prevalence among children under-5 (%)	37	—	27	Improving	
Stunted prevalence among children under-5 (%)	—	—	40	but slipping	
Prevalence of HIV/AIDS, female (% 15–24 years)	—	—	0.06	No change	<0.06

Note: — = not available; HIV/AIDS = human immunodeficiency virus/acquired immunodeficiency syndrome.

^a Date is indicated for approximate calendar period.

Sources: Demographic Health Survey (1997 and 2003), United Nations Children's Fund, World Health Organization, World Bank.

3. Key Development Issues and Challenges

303. Indonesia spent less on health care than its neighbors—about 3.1% of GDP in 2004 compared with an average of 5% in East Asia and Southeast Asia. WHO advises that about 5% of GDP be spent for health.

304. Low public sector spending in health adversely affects health systems' performance. Overall resources in the health sector increased from 1.6% of GDP in 1995 to 3.1% of GDP in 2004, but the share of the public sector declined from 46% to 34%. The public sector contributed 1.1% of GDP in 2004. Of total public expenditures, only 2% was allocated for health in 2004. Per capita health expenditure is at about \$30 per annum in 2004.

305. Under-funding is chronic for health infrastructure and operations. Significant decline in resources, and the chronic under-funding in the public sector in the past decade, has adversely affected infrastructure development, operating costs of facilities, and retention of public sector staff. Many public sector health facilities currently suffer deterioration in buildings, and more so, many do not have operations budget to maintain buildings, or repair equipments, and especially face shortage in medicines. Many health facilities, especially those in the remote areas face dire concern. External financing of the health sector are overall low (about 10% before 1997), but have been a significant contributor towards public sector development investment.

306. Local health spending on health care is not equitable. Since decentralization, financing sources are split between central and district governments: the central government contributes approximately 70%,¹ while the district government contributes about 30%. Decentralization has also resulted in inequity in resource availability for health care, given that decentralization is all the way to the district levels, and little central or provincial government financial support can be expected for those that are resource constraint.

307. Capacity effective decentralized government is poor. The country decentralized in 2001. Although, decentralization has provided more autonomy to local governments, especially in public service delivery, further work is required to build institutional capacity, to re-distribute and to improve skills-mix of health provider, planners and managers, and to improve systems of planning, accountability and transparency.

308. The people, especially the poor and the near-poor (together over 25% of the population), shoulder a large health care cost burden. People have limited opportunities to participate in risk-sharing schemes and consequently must face the particularly high costs of catastrophic illnesses, they avail themselves of services from the private sector that charge user fees, they purchase drugs from pharmacies where prices are not necessarily regulated, and they travel long distances to access health care. All this adds up, and therefore the out-of-pocket expenditure is estimated at about 70% of total health expenditures.

¹ Funds flow from central to local government in the form of united (DAU) resources for operations and maintenance, and tied (DAK) resources for infrastructure. The DAU does not come with a guideline for the use of resources, and thus creates issues for health resource needs.

4. Government Policy and Planning Framework

309. The National Mid-Term Development Plan (RPJM) of 2004-2009 states that health is a priority of the Government, and has outlined health development programs to be undertaken over the 5 years. Subsequently, the MOH Strategic Plan for 2005-09 has outlined specific activities to be funded by MOH, and provided work plans and budget requirements for 2005–2006.

310. In these documents, MOH highlights its key priorities as (i) reducing the disparity in health outcomes; (ii) focusing on the double burden of disease (reemerging or newly emerging communicable diseases and noncommunicable diseases); (iii) improving health service delivery performance (including distribution of health manpower), especially addressing the needs of the remote and underserved population; (iv) improving the efficiency of the planning and budgeting process, especially in the districts; (v) evidence-based programs, and improving monitoring and evaluation; and (vi) strengthening the role of MOH (for policy, advocacy, and facilitation).

311. MOH's strategy covers four main areas: (i) mobilizing and empowering communities; (ii) improving quality of health services; (iii) improving health surveillance, monitoring, and health information systems; and (iv) increasing health financing. Although the strategy has an appropriate direction, it is not necessarily SMART.² ADB could provide assistance to help the Government refine their health policies and streamline their health strategies with specific and targeted activities, budgets and timeline. MOH may require assistance to develop the medium term expenditure framework (MTEF).

312. In 2005, MOH introduced three key programs focusing on MDGs: (i) National Safe Motherhood Initiative, (ii) Integrated Management of Childhood Illnesses (IMCI), and (iii) National Nutrition Plan. The Government is also focusing initiatives to reduce the spread of communicable diseases. ADB could provide assistance to help the Government meet the MDGs.

313. In 2005, in response to the fuel subsidy reduction, the Government introduced a program to subsidize the health care costs of the indigents through the Kartu-Askes-Gankin program. This was a program also in support of the social health insurance program covered under the Social Security Law of 2004. The Government aims to cover the indigents (living below \$1 a day) and the near-poor (those living below \$2 a day) under this program to provide free primary health care, and to subsidize secondary health care. The program, however, needs to improve its targeting methodology to ensure the poor are covered. However, the program is still under-funded and unable to address the health care costs of the poor. In addition, the third party insuring institution—PT-Askes—will need to strengthen its institution through policy and programmatic reform. ADB could provide assistance to strengthen such institutions.

314. National health accounts are in place. However, given that district governments could provide at least 30% of the public sector funds in health, and the private sector provides up to 70% of health expenditure, it would be important to identify the resources available to advocate for wiser spending patterns.

² SMART = specific, measurable, achievable, realistic and time bound.

5. Institutional Arrangements

315. Levels of administration require identifying their roles within the decentralized framework. Since devolution, a strategy for strengthening management capacity at the provincial and district health administration is critical. The central Government is responsible for developing policy, regulations, standards and guidelines, while the provincial government is responsible for supervision and monitoring, and district government for health service provision. The functions of decentralized governments could improve drastically through the development of a central framework on the responsibilities of the various decentralized tiers of government, as well as improved governance, and appropriate skills development.

316. Central Government institutions require reform. MOH is struggling for a clear direction. Although, MOH has identified key areas in the national strategy, detailed reform activities cannot be identified without appropriate data on the current situation (and therefore targets to be achieved), and therefore resource needs (given the inadequate information particularly on the local sources of financing). Post-decentralization, MOH still struggles to identify its role, and to reform the central institutions to follow their main mandate of policy, advocacy and monitoring. The Central Ministry (MOH) has not prepared a strategy for its own reform, in strengthening central institutions and staff skills-mix to address their new role. Externally financed projects have often provided support for advocacy and for defining and strengthening roles of local governments, but little support has been provided (or accepted) for central government reform to fit into its new role under decentralization.

317. Local health service delivery needs integration. Although, health service delivery was decentralized (by MOH) in the earlier phases of decentralization, the Family Planning Institution (BKKBN) only recently decentralized its service delivery activities. BKKBN activities are to integrate within the health service delivery system, its staff re-trained as integrated (rather than vertical) service providers, and health sector staff re-trained to accommodate for family planning services. ADB funded DHS2 may be among the first development partners to support this integration at the local levels, and attempt to bridge a relationship between the central institutions (MOH and BKKBN are currently vertically run at the central level).

318. Health service delivery system needs realignment and quality strengthening. Since devolution, the responsibility of health service delivery lies with the local (district) governments. Currently the public health service delivery systems are disconnected given that the management and financing of the services is fragmented under different levels of administrations (district, province, central). In addition, Indonesia faces a dual burden of disease and requires appropriate mix of services with adequate staff skills to address this concern. Several externally funded projects are supporting in this effort, given that the devolution is all the way to the district levels (there are approximately 33 provinces and 450 districts in Indonesia) (Map A.1).

319. Public-private sector collaboration could improve coverage. Because of the declining quality of services in the public sector facilities, currently, a large proportion of the population use private health facilities, and in some provinces, as much as 70% of the population use private sector services. Despite this, no comprehensive plan exists on health services planning (both public and private sectors), and little attempt is made by the public sector to initiate dialogue to consider public-private mix in health service delivery. Given the large capacity of the private sector (and NGO) in health service delivery, and the large utilization of private health facilities by the population, the Government could work closely with the private sector and NGOs in improving access to and affordability of the population to appropriate quality health care. Appropriate

regulations to standardize and monitor service delivery could sustain good quality of care. The Government has been less keen to receive support in this area.

320. Strengthening commitment for health at local levels could improve resources for O&M. Systemic issues and decentralization constraints have posed a challenge to Indonesia implementing many of their health programs. The sector overall faces serious resource constraints, felt primarily in the recurrent budgets. Decentralization has resulted in a slow down in some program performances, as program implementation responsibilities lie with the districts, and not with the central government; whereas, the commitment to the cause don't always transfer from central to local levels. Finally, monitoring systems are not in place, and therefore data are unreliable to track the vulnerable or the impact of programs on the beneficiaries.

321. Performance-based budgeting could improve efficiency. Resources allocated for health service delivery are primarily under the authority of the district government and local parliament. It is up to the district health office to negotiate the appropriate resource package for health. In most cases, the power of negotiation, rather than health care needs or performance has so far been the determinant of the size of the health resource package for each district. The district health office lacks capacity to plan, budget, negotiate and manage its finances. The central Government too is advocating for a performance-based budgeting to be established, which will help in a more needs based budget allocation, however, capacity needs to be built to manage the process. Under the various externally funded projects, district capacity is being strengthened for effective planning and for wise spending of the limited resources in health. In addition, the central level expects to move to a unified budgeting system that will help in efficiency gains.

322. Alternate financing could be considered to reduce inequity in resources. The low public sector spending in health has been felt more in some districts than in others. Provinces (relative to districts) receive limited central budget support, as responsibilities are devolved to the district levels. Funds flow from central to province and district government in the form of untied (DAU) resources for operations and maintenance, and tied (DAK) resources for infrastructure development. The DAU is not earmarked for health, is not accompanied with a guideline for the use of resources, and appropriate supporting government regulations are not stipulated. Subsequently, some districts allocate more resources for health care, then other districts, but the districts with surplus resources do not have the flexibility to share resource across districts (no existence of equalization funds). The Government requires to provide financing options (such as some form of equalization fund) to release the inequity in resources constraint created after decentralization, so that adequate funds can flow to address the shortage.

323. Reducing out-of-pocket expenditures could improve affordability by the poor. Affordability to health care is a concern, especially among the vulnerable groups. Health care of all government employees, retirees and their families are covered through a civil servants' health insurance scheme (PT-Askes). Private sector employees may be covered under a compulsory health insurance scheme (PT-Jamsostek), but its coverage remains low. The Government has recently passed a social insurance law, which includes social health insurance scheme, for which operation mechanisms are unclear. An intermediate framework has to be developed, to address the challenges of coverage to affordable health care for the vulnerable, and have to be addressed immediately. Limited support is provided in the area by externally financed projects.

6. Role of Development Partners

324. The primary development partners in health over the past 15 years have been ADB, the World Bank, USAID, Austria, and the Republic of Korea, among others (Table A6.12). The multilateral banks primarily are major development partners providing assistance for infrastructure development, as most other development partners are providing TA grants only (Map A.1, which indicates where the various development partners are providing support for health, and Appendix 3 of ADB. 2003. *Report and Recommendation of the President to the Board of Directors for Proposed Loan to the Republic of Indonesia for the Second Decentralized Health Services*. Manila. Loan 2074-2075, approved on 19 December 2003 for the amount of \$100 million.

Table A4.12: International Donor Assistance for Health Sector Support in Indonesia (1991–2006)

Development Partner	\$ million
ADB	832
IBRD	592
IDA	31
Austria	155
USAID	135
Korea, Republic of	107
France	75
AusAID	60
JBIC	55
JICA	13

ADB = Asian Development Bank, AusAID = Australian Agency for International Development, IBRD = International Bank for Reconstruction and Development, IDA = International Development Assistance, JBIC = Japan Bank for International Cooperation, JICA = Japan International Cooperation Agency, USAID = United States Agency for International Development.

Note: Does not include projects in the pipeline, and those not approved yet.

Source: Appendix 3 of RRP of Loan-2074/75-INO

325. A sector-wide approach is being developed in two eastern island provinces (NTT and NTB), where development partners include the local governments of these provinces, ADB, GTZ, KfW, French, AusAID, and others. These are the provinces where ADB's funded DHS-2 is active, and through which ADB is participating in the SWAP for health. Most development partners will be providing financial support for TA, and for equipment for basic care. ADB is seen as the complimentary development partner to support infrastructure development. ADB has also provided assistance to the SWAP activities through a consultant from TA 3579-INO (co-financed between ADB and AusAID, and attached to the Decentralized Health Services 1, and 2 projects).

326. A donor's forum exists in the health sector, which MOH is supposed to lead in coordinating, but the meetings are often coordinated by development partners (in rotation), and where key representatives of MOH are not always present to engage in dialogue (instead a junior staff may participate to take notes). The lack of ADB sector specialist in the country often means that ADB is not able to contribute substantially in these forums.

327. ADB has had a substantial role in Indonesia, but would need to work much more closely with other development partners if it wants to effectively contribute to the substantial reform agenda, that will take 20 years or more to plan and implement. While the first strategic trust and its reform agenda is the obvious priority for ADB, the second one is a much broader and long-term agenda, where ADB may also play a role in selective areas linked to its expertise in governance and

financing, and as opportunities arise with the development partners. This area will need further documentation and exploring in the coming months.

7. Capacity and Approach to Managing for Development Results in the Sector

328. The National Statistics Bureau (BPS) currently conducts the SUSENAS surveys annually. The survey provides information on health service use by income group and by health service provider. However, the data may not be representative at the district level, and given that, the country has decentralized to the district levels and requires data at district level for decision-making suggests that SUSENAS sampling framework will need to be revisited.

329. After decentralization, the Health Information System became fragmented, and data is not collected or analyzed for decision-making. The central Government's Center for Disease Control has developed a model for district, provincial, and national epidemiological surveillance system whereby infectious disease epidemics can be detected early and the situation monitored closely in the field. However, the system is not functional countrywide. WHO and other organizations are supporting such initiatives.

330. The health system's performance data is not systematically collected and therefore evidence-based policy development is often limited. Limited effort is seen in this area, although the ADB-funded DHS2 is advocating strengthening facility-based HMIS, especially given the recent National Health Strategy prioritizing health information system strengthening.

331. With the status of the information base, MOH may not be in the situation to rely on evidence-based policy development. However, with the assistance of development partners, the next few years could start to see improved data for decision-making.

8. Successes and Lessons Learned by ADB in the Sector

332. Health sector reform projects have generally been difficult to implement under the environment of decentralization, as the country lacks capacity at the local levels for its implementation, and at the central level no strategic policy direction has yet been offered.

333. MOH has not undergone an institutional reform or recruited/strengthened appropriate skills mix to address its new role, and therefore it is difficult for projects to receive appropriate guidance from MOH staff, or to dialogue with them to move the reform agenda forward.

334. The Ministry of Finance (MOF) has advocated for a low utilization of technical assistance under the lending projects, and particularly do not want to recruit international consultants. Indonesia is a large country, and the needs are high, however, it is not necessarily easy to find internationally experienced skilled consultants in the country.

335. The Government's project implementation unit (PIU) staff often lack skills and knowledge, even of their own government procedures of procurement and financial management. Although ADB provides training to PIU staff on ADB procedures, the turnover of these staffing, especially in the local levels, is high.

336. In addition, the country's budgeting process and cycle has greatly constrained smooth project implementation. MOF's new financial management system is supposed to ensure timely resource distribution and transparency. However, local government still lacks the capacity to use

the new system, and it will be a few years before its efficient functioning is assured. This has caused much delay in project implementation and disbursement.

337. Project external audits have often reported corruption and collusion, especially in the local levels. This is not unique to the health sector projects. Given that decentralization is all the way down to district levels, it is often difficult to monitor the existence of these problems early on. However, steps are being taken with the assistance of resident mission to establish early detection of this problem, and help build systems for accountability.

338. ADB has been active in providing support to the Indonesian health sector since 1990. ADB therefore has a good and strong relationship with MOH and other related agencies in the country. Many reforms undertaken under ADB-funded projects are often cited in many references, especially the Social Safety Net Project from the mid-1990s.

339. ADB, in its support for the health sector, has primarily helped address the needs of lagging communities and improving health sector efficiency. However, this was focusing on access and service delivery, rather than contributing to more comprehensive reform approach supported by the development partners, so as to ensure sustainable results.

340. ADB's initial experience with decentralized health projects have taught us how important it is for central government to lay down the parameters, and build strong implementation capacity at the local levels. Both trusts need to be placed within the overall context of health sector reform. In particular, it is evident that efforts to improve access for lagging communities needs to be accompanied with policy reforms and capacity building so as to sustain impact. In that sense, and also given the sometimes remote locations of these communities, a program modality should be preferred. In its continuity in dialogue, ADB is able to move the agenda forward on policy reform through its projects, and help build local capacity for improved health systems performance.

9. Current ADB Operations and Commitments

341. Since 1980, ADB has been providing assistance to the health sector through its first technical assistance in July 1980. ADB's assistance for lending in the health sector started in October 1985. Since the 1980's, ADB has provided \$853 million in loans, and \$9.5 million in grant assistance to the health sector in Indonesia. The current two ongoing loan projects assist the government in strengthening the capacity for decentralized health services. The next set of health projects under consideration are focusing in the areas of nutrition, and communicable diseases, and health policy strengthening. ADB's ongoing loan and technical assistance projects are presented in Table A6.13.

Table A4.13: Indonesia, ADB Assistance in the Health Sector (as of September 2005)

Item	Assistance in \$ million	
	Loan	Grant
Projects		
Decentralized Health Services (2001–2006)	75.0	
Second Decentralized Health Services (2005–2010)	100.0	
ETESP (2005–2008)		17.0
Nutrition Improvement through Community Empowerment (2006–2011)	50.0 pipeline	
PRMAP (2006–2007)	200.0 pipeline	
Technical Assistance		
Supporting Decentralized Health Services		1.2
SARS prevention and control (RETA)		0.2
Enriching Lives of the Urban Poor		1.75
Food fortification (JFPR)		
Urban Nutrition (PPTA)		0.4
Supporting Community Health Initiative for Aceh		2.0
Supporting PRMAP		3.0 pipeline
Total		
	325.00	
	27.55	
- Ongoing	175.00	2.55
- Planned	250.00	5.00

ETESP = Earthquake and Tsunami Emergency Support Project, JFPR = Japan Fund of Poverty Reduction, PPTA = Project Preparatory Technical Assistance, PRMAP = Poverty Reduction and Millennium Development Goals Acceleration Program, RETA = Regional Technical Assistance, SARS = Severe Acute Respiratory Syndrome .
Source: Asian Development Bank.

10. Proposed ADB Role in the Sector/Theme

a. Millennium Development Goals

342. Half of MDGs and one third of indicators directly relate to the health sector. If MDGs are to be achieved, this requires major efforts in the health sector, amongst others. ADB's assistance to Indonesia's health sector over the years consistently shows two major strategic trusts, namely (i) a focus on the poor and vulnerable, and (ii) support for health sector reform. As shown below, the needs of the most vulnerable can not be addressed without some level of health sector reform. In addition, there are more macro-reforms that ADB has helped addressing, in particular decentralization of health services. However, these trusts/pillars need to be made more explicit and results-oriented and strongly anchored in long-term government policy and donor coordination.

b. Growing Inequity—Addressing the Needs of Lagging Communities

343. On further analysis, MDGs are in particular not being achieved because of high residual mortality in poor, lagging communities—isolated by water, jungle, mountain, extreme poverty, conflict, or social isolation. These communities, not able to benefit from mainstream infrastructure and services, lack some of the most basic assets of subsistence farmers—health, nutrition, and education—that would help them to improve their productivity. Most of these communities would be remote, but could also include urban slum dwellers with a somewhat different set of problems.

344. The main reasons for poor health indicators in these lagging communities are common communicable diseases (diarrhea diseases, pneumonia, malaria, worm and skin infections), malnutrition (micronutrient deficiencies such as iron and iodine deficiency, poor diet and feeding habits) for both remote rural populations and urban slum dwellers. Achieving MDGs will require reaching these neglected communities with basic health and nutrition care and education.

345. Providing services to these lagging communities requires further improvement of the public health system, in terms of planning and management, monitoring, human resource development (local staff), outreach services, and financing. Providing these services is especially challenging in a recently decentralized public health system. Such a system requires time for capacity building, and, as was evident in other countries, may initially aggravate inequity by focusing on mainstream and popular health services rather than for isolated and vulnerable groups. The development of services for these groups very much depends on the commitment and capacity of local planners, who, unless provided with special training and support, may find it difficult to give priority to these groups. Targeting isolated populations requires additional resources for reaching them, and a considerable incubation period before results can be shown.

346. The growing inequity between these groups and the mainstream public needs to be addressed in various aspects:

- (i) Capacity building of local planners, and creating an environment for these planners to be more flexible and innovative, and have substantial decision making authority and accountability for addressing the needs of these groups.
- (ii) Introducing results-based financing for local governments, with special incentives for lagging communities.
- (iii) Partnership with local leaders, traditional health care providers, and local developers.
- (iv) Improving the financing of services for communities lagging in health indicators.
- (v) Human resource development for lagging communities, including training and posting of staff from these communities, thereby also creating local employment opportunities.
- (vi) Improving the quality of services for lagging communities, including provision of facilities that is strategically located and accessible for both local communities and district authorities, and properly staffed, equipped, supplied and supervised.
- (vii) Making services more affordable, e.g., through the provision of free health care for these groups using equity fund or other arrangement.
- (viii) Develop public-private partnership (including NGOs) to improve access to appropriate quality health care. Appropriate standards and monitoring mechanisms will need to be established to administer this.

c. Growing Demand – Improving Health Sector Efficiency

347. Population increase and unemployment, the epidemiological transition with an increasing number of chronic welfare diseases and road accidents, emerging diseases including HIV/AIDS

and Avian Influenza, and higher demand for medical services and expensive medical technology puts increasing pressure on the Government to increase spending on health services in a slowly recovering macro-economic environment. While spending in health services in Indonesia almost doubled between 1995 and 2000, from 1.6% to 2.7% of GDP, this growth was mainly in the private sector. Public health spending declined by half as a proportion of total health spending, and at \$19 per person remains well below the level of per capita income and regional average.

348. Given fiscal constraints, it will be difficult to expect a rapid increase in public health financing. However, there are substantial opportunities for improving sector efficiency and impact of limited resources. This requires a rethinking of the role of the government in the financing and delivery of health services, which has been very much the concern of the Government. The Government has developed considerable planning and budgeting capacity over the past decade. For example, it succeeded in shifting a substantial part of the budget to peripheral health services and away from hospitals.

349. The Government needs to undertake further reforms to adjust its role according in accordance with initiated reforms in the public sector and the newly emerging private sector. Several priorities are identified:

- (i) Strengthen central planning capacity for health reform, covering a range of topics such as private sector development, hospital autonomy, health economics, decentralized management, and human resource development.
- (ii) Provide provincial and district health administration a national framework on the responsibilities of the various decentralized tiers of government, as well as improved governance, and minimum service standards; and provide capacity building for these levels.
- (iii) Move toward a needs and results-based budgeting system to improve efficiency. As resources allocated for health care are under the authority of the district government and parliament, the power of negotiation, rather than health care needs or performance determines the size of the resource package for each district. In addition, poorer districts are unable to secure larger resource packages, as resources are not pooled. In addition, the central level will move to a unified budgeting system that will help in efficiency gains.
- (iv) Improve arrangements to make health services more affordability for the poor. This would include expansion and improvement of the recently approved – but not yet operational – social health insurance scheme.
- (v) Develop a human resource development plan addressing work force size, skills-mix, staff diversity and distribution, and quality of training institutions, and personnel management.
- (vi) Gradually shift Government spending towards health care for the poor, services with high externalities, and public goods, and encourage increasing public-private partnership, hospital autonomy and other arrangements to increase cofinancing.
- (vii) Mandated to ensure the quality of care in the private sector, strengthen policies, regulations, strategies, standards of care, and quality control mechanisms for the

private sector, and also strengthen the self-regulatory capacity of the private sector, e.g., through professional associations and accreditation mechanisms.

11. Proposed Sector Outcomes and Outputs to be Supported by ADB

350. Identify (i) realistic development outcomes at the end of the CSP (2009) – based on government targets if possible; (ii) indicators of progress toward those outcomes, in the form of progress and process indicators which can be measured during the CSP period (perhaps annually); and (iii) a definition of ADB's expected contribution to the achievement of the outcomes, progress and process indicators. Identify no more than one or two key outcome indicators and perhaps four to five progress and process indicators should be identified.

351. Indicators of ADB's contribution should be measurable at the output level in our project/TA frameworks. Make sure that ADB's proposed contribution takes into account results expected during the CSP period from currently ongoing activities.

12. Proposed ADB Activities

352. ADB has ongoing investment lending projects in the health sector worth \$179 million. DHS-II became effective in 2005. Through these projects, ADB is supporting in building local government capacity and local institutional reform. An attached \$2 million technical assistance helps streamline and move the local reform forward.

353. However, the main gaps are felt in national policy reforms, and strengthening national institutions. Two projects are therefore proposed for the coming years:

- (i) Poverty Reduction and Millennium Acceleration Program (PRMAP), which will primarily support reform efforts in the health and education sectors (in essence 50% for each of the two sectors). The Program loan (OCR) is expected to be \$200 million for the tranche to be released in 2007, and with a further development for a second program loan with an additional \$200 million to be released in 2008.
- (ii) To support PRMAP effort, a grant technical assistance of \$10 million is proposed, \$5 million of which is for the health sector to be used over the next 4 years to support MOH and other central government institutions in achieving policy and institution reform. Source of this TA is not confirmed, although, for health, communications are taking place with AusAID.
- (iii) Urban Nutrition Project (UNP) is proposed for 2006, with an amount of \$50 million from ADB's ADF lending resources. This would be a five-year investment project loan, and will help move the national priority and meet MDG related to nutrition.
- (iv) Additional economic and sector work is required to understand issues better, and to substantiate ADB's involvement and commitment to reform. This is not a strength of ADB, but needs to be given more attention by ADB.

J. Agriculture, Natural Resources, and Environment

1. Introduction

354. The purpose of this document is to describe the key issues and challenges facing Indonesia in agriculture, environment, natural resources and rural development. It is about the Government's response to these challenges and how ADB proposes to engage with the Government and other stakeholders to address the challenges in the period 2006-2009. The road map is based on consultations held with the government agencies and other stakeholders over the past years, and findings of ADB technical assistance, ADB sector and thematic analyses and loan projects.

2. Summary Situation Analysis

355. Indonesia, with more than 17,000 islands and over 80,000 kilometers long coastline, is the largest archipelagic country and is the richest country in terms of biodiversity. It is endowed with fertile volcanic soils, ground and surface water, a skilled population, and a tropical climate that allows year-round cultivation. It has some 500 rivers of substantial size that reach the sea and are grouped into river basin areas.

356. To date, natural resources have been the backbone to national economic growth, and they will still be heavily relied upon for the medium term. Forestry, agriculture, coastal and marine and mining sub-sectors contribute to the tone of about one fourth of the GDP, which is a major decline from over 50% of the GDP in 1970. Nonetheless, the sector is still home to the largest segment of Indonesian population and the poor, and has a primary role in achieving overall country objective of poverty reduction. In 2002, sectoral wages and farming incomes contributed 43% to rural household incomes, and the sector employed 45% of the overall labor or 67% of the rural based labor force (BPS National Labor Force Survey 2002). During the economic crisis of the late 1990s, the sector served as a safety net by providing additional employment and income for individuals that were laid off from urban employment due to the crisis.

357. The country is rich in natural resources; however, these resources are under immense pressure. Java Island is home to 60% of the population, but constitutes only about 7% of the land area. Even though the average water demand is only about 1.7% of total runoff, it is heavily concentrated in Java and annual runoff utilization in some critical rivers approaches 50%. About 50% of the land is swampy and barren, while areas in the east with long dry seasons cannot support dry land farming. About 22% of the population lives along the coasts, and about 60% lives in the coastal plains that house settlements, industry and locations for agricultural production. The high population density and related environmental problems such as agricultural and industrial waste places an added pressure on in the coastal areas that are some of the richest areas of biodiversity in the world including arguably the coral biodiversity centers of the world. Natural disasters are also rife, and their effects are heightened by illegal logging and poor agricultural practices.

358. The Medium-Term Development Plan (RPJM) states that natural resources will be utilized for enhancing welfare of the people by taking into account the preservation of functions of the natural environment. Natural resources have two roles, as assets for economic growth (resource based economy) and as life support systems. The efficient and sustainable management of the natural resource base, is a key challenge to the Government and the ADB. Success will benefit long-term development of the agriculture, water, fisheries and forestry sectors, and reduce poverty.

359. One of the world's most centralized countries has been turning into one of the most decentralized. But the districts and municipal areas are generally ill prepared for the challenges. About 77 million people have no access to clean water and limited access to good sanitation. Once self-sufficient in rice, the country has become a major importer owing to deteriorating infrastructure, poor water management, and low agricultural extension support. Competition has increased between natural resources sub-sectors, which also suffer from poor governance, low capacity, and low motivation. The close links between empowerment, poverty reduction, and good governance are gradually being recognized.

3. Key Development Issues and Challenges

360. To date, the sector has been the backbone of national economic growth, and will still be heavily relied upon in the medium term. In particular, the sector has a key role to play in achievement of MDGs 1 and 7. Analytical and sector works supported by ADB identify the key strategic challenges in medium to long term as (i) low capacities of the stakeholders, especially the regional governments and communities in management of the sector; (ii) shift to a management of water resources in an integrated and sustainable manner; (iii) competing demands for the water resources and poor upkeep of the related infrastructure; (iv) low level of user participation in water resources and irrigation management; (v) high pressure on forest, coastal, and marine resources for supporting livelihoods in the rural and coastal areas; (vi) lack of adequate user participation in management of natural resources and overall weak management of coastal and marine resources; (vii) sustainable and environmentally friendly growth in rural economy through improved productivities in marine, agriculture, and fisheries subsectors; (viii) development of a viable non-farm rural economy through promotion of agribusiness and rural industrial clusters; and (ix) rural population's lack of easy access to markets and services. Any strategy to meet these challenges would require active and constructive collaboration of the three broad stakeholder groups: the Government, private sector, and the civil society.

4. Government Policy and Planning Framework

361. **Water Resources and Irrigation Management.** The National Water Resources Policy takes a holistic approach to the management of water resources for their sustainable use. Private sector participation is part of the development agenda, but, in the current investment climate, has not been significant. The RPJM aims to address the following specific constraints in the water resources sector (i) the degradation of river basin areas; (ii) weak water sector coordination, institutions and administration at national, river basin, district, and community levels; (iii) weak rare event flood and drought management; (iv) spatial and time imbalances between water supply and demand; (v) increasing conflicts between water sub-sector services; (vi) non optimal irrigation infrastructure utilization; (vii) inequitable community water access, poor hygiene behavior; (viii) low quality data management, information systems and research and development; and (ix) poor financial performance with under funding, low irrigation service fees recovery and inadequate fund sharing.

362. **Environment and Biodiversity Conservation.** RPJM 2004–2009 identifies various issues and challenges associated with the management of natural resources (here: excluding forestry, oil, gas and mining), including (i) degradation of habitats of coastal and marine ecosystems, an (ii) imminent threat to biodiversity, (iii) water and air pollution, (iv) not yet fully resolved border problems with neighboring countries reflecting particularly the management of marine resources, (v) not yet optimally utilized marine potential, (vi) proliferation of illegal fishing and destructive fishing methods, (vii) not yet optimal management of small islands, (viii) not yet developed system for mitigating the impacts of natural disasters, (ix) absence of integrated waste

management, (x) not yet synergic laws and regulations on the natural environment, and (xi) low awareness of the general public on the importance of conserving the environment.

363. Agriculture and Rural Development. RPJM 2004–2009 identifies the main constraints to sub-sectoral growth including (i) relatively high poverty and low welfare of farmers and fishermen; (ii) weak institutional aspects and bargaining position of farmers and fishermen; (iii) inadequate incentives to invest in production increases, associated with need for land reform and access to capital; (iv) low level of technology transfer for the processing of products resulting in low productivity; (v) inappropriate aquaculture development; (vi) imbalances in utilization of fish stocks; (vii) high dependence on rice consumption as major food crop; and (viii) lack of basic infrastructure and poor access to markets and services. As part of the MTDP 2004–2009 the Government has initiated a drive for revitalization of the agriculture sector including fisheries with the objective an annual average growth rate of about 3.5% during 2004–2009 and increased incomes and well being of farmers. This is to be achieved through specific programs focusing on (i) increasing food resiliency, (ii) developing agribusiness, and (iii) developing fisheries resources.

5. Institutional Arrangements

364. Central Government institutions engaged in the related subsectors include the Ministry of Agriculture (MOA), Ministry of Public Works (MPW), Ministry of Marine Affairs and Fisheries (MMAF), Ministry of Home Affairs (MOHA), and State Ministry of Environment, as well as the Ministry of Forestry and, as a coordinator, the BAPPENAS. In accordance with Laws 32/2004 and 33/2004, the management of natural resources was decentralized; however, the levels of decentralization and authorities for management of natural resources differ between the sub-sectors.

365. Water Resources and Irrigation Management. Water resources development and management is carried out at the central level by the Ministry of Public Works (MPW) under the Directorate General of Water Resources (DGWR). Besides the management of water resources, DGWR is concerned with planning and programming; water resources management; irrigation; rivers, lakes and reservoirs; and swamp and coastal development of rice irrigation projects. It is divided into five functional directorates—river basin planning, planning and programming, coastal and swamps, reservoirs lakes and dams, and irrigation. NWL 7/2004 requires establishment of water resources councils at the provincial and district levels, and in special cases also at the river basin level.

366. Environment and Biodiversity Conservation. Ministry of Forestry, Ministry of Marine Affairs and Fisheries (MMAF), and State Ministry of Environment are the main institutions in the sub-sector. Ministry of Forestry is responsible for management and conservation of forest resources including mangrove forests. MMAF is the principal national agency responsible for coastal and marine resources, which provides the policy and technical support to the district governments in management and conservation of these resources. State Ministry of Environment also involved in management of coastal resources and biodiversity conservation through promoting national strategy on mangrove conservation in collaboration with Yayasan Mangrove Indonesia, the Indonesian Mangrove Foundation, Ministry of Forestry, Home Affairs, and BAPPENAS.

367. Agriculture and Rural Development. Principal institutions in the sub-sector include MOA, MPW and MOHA at the national level, and district governments and provincial governments at the regional levels. In case of Agriculture, MOA's is tasked with policy formulation, research and development, agricultural quarantine, food distribution and coordination

while extension services and implementation level responsibilities largely rest with the district governments. In case of rural development, MOA, MPW and MOHA are all actively involved in the sub-sector through coordinating and backstopping the district governments in implementation of initiatives relating to rural livelihood and infrastructure development.

6. Role of Other Development Partners

368. The World Bank (water resources and irrigation management, environment and biodiversity conservation, and agriculture and rural development), JBIC (water resources and irrigation management, and rural development), IFAD (agriculture and rural development), Government of Netherlands (water resources and irrigation management), Australian Aid (agriculture and rural development) and USAID (environment and biodiversity conservation) have been actively supporting the sector. Historically the development partners had a sectoral focus and worked through various national level ministries, bilateral development partners such as the Australian Aid have been increasingly adopting a thematic approach focused on a geographic area.

7. Capacity and Approach to Managing for Results in the Sector

369. Indonesia has well developed systems for reporting on the overall economy as well as sector and region specific statistics. Functions of the National Statistical Agency (BPS) are replicated at the regional levels by the provincial level statistical agencies. Sector specific reporting is undertaken by the concerned ministries, which include bureaus specifically tasked with reporting responsibilities. BPS undertakes a number of surveys including SUSENAS and PODES, which report on socioeconomic aspects. While SUSENAS is survey based, PODES periodically reports on every single village in the country.

370. While adequate systems are in place for reporting, there are lags between the time when data is collected and when it is available to users. In case of SUSENAS and PODES, the lag is anywhere from 12 to 24 months, which may be too long for effective management based on results. In addition to the lag, there is also a need to shift the focus of managers from output monitoring to results based monitoring. Shift is anticipated to be gradual and will require capacity building in the relevant ministries as well as a paradigm shift where clear targets are set at the planning stage.

8. Successes and Lessons Learned by ADB in the Sector

371. Of the 48 agriculture and natural resources projects approved since 1990, 34 were for agriculture including fisheries and 14 were oriented toward natural resources management. PCRs are available for 17 projects, which covered agriculture, agro processing, irrigation and marine and coastal sub-sectors. Of these over 90% were either successful or partly successful. The lone unsuccessful project was in the area of agro processing.

372. The country assistance program evaluation for Indonesia (CAPE),³ completed in December 2005, reports that in general projects in the sector suffered implementation delays, which were mainly on account of issues relating to decentralization, compensation, counterpart funds, and consultant recruitment. Some of the salient lessons learned from the recently completed and currently ongoing projects include (i) long-term partnerships, especially in subsectors where the Government has a clearly laid out program and strategy lead to continuity

³ ADB. 2005. Indonesia Country Assistance Program Evaluation. Manila

of reforms and initiatives and enhancement of development impact; (ii) natural resources management initiatives are more likely to succeed if these follow an integrated approach addressing environmental and socioeconomic concerns, and are designed and implemented through full involvement of communities and regional governments; (iii) small infrastructure works contracted to the communities lead to a high sense of ownership, greater cost effectiveness, and good quality of works; (iv) post project infrastructure asset management plans should be formulated in a participatory manner as part of project implementation and should include clear demarcation of responsibilities of each of the stakeholders in a partnership agreement; (v) education and information campaigns are effective ways of increasing awareness of stakeholders in natural resources management; and (vi) projects should include measures to promote and facilitate private sector's role in the sector as service providers, development partners, and marketing channels.

9. Current ADB Operations and Commitments

373. The strategic thrust of ADB's sector operations had been on reducing rural poverty by supporting equitable and sustainable growth in the rural economy. ADB has actively supported the development in the sector by focusing on the agriculture production, agro processing, agribusiness, natural ecosystems protection, integrated water resources management, biodiversity conservation, fisheries, forestry, irrigation and drainage, flood control and livestock sub-sectors. As of end of 2005, ADB provided 103 loans for \$4,176.2 million and 151 TAs for \$68.8 million for agriculture and rural development, including irrigation, livestock, fisheries, forestry and rural development. Over the years, ADB has increasingly been selective in providing assistance to the sector, focusing on the niche areas of experience and specialization where it has a comparative advantage. For example; the involvement in forestry and livestock sub-sectors has virtually been phased out, while in water resources management and irrigation, and marine and coastal resources management, sub-sectors ADB has emerged as lead development partner of the Government.

374. **Water Resources and Irrigation Management.** The Participatory Irrigation Sector Project⁴ (2064/2065-INO; PISP) Project supports a participatory approach to the management of irrigation and water resources in a decentralized administrative and fiscal environment. Improved irrigation performance over 600,000 ha will benefit some 1.5 million farming families in 25 districts in Lampung, Banten, West Java, Central Java, East Java and South Sulawesi provinces. Grant 0002-INO: Earthquake and Tsunami Emergency Support Project - Irrigation Component supporting rehabilitate a total service area of about 70,000 ha. The work covered in the Project will depend on the prioritization of damage from the above occurrences and on the evaluation of needs in restoring normal irrigation water supplies by emergency repairs, systematic and participatory rehabilitation and reconstruction of irrigation systems, effectiveness in restoring livelihoods and incomes, ability to provide the staple food to local populations.

375. **Environment and Biodiversity Conservation.** Ongoing loan projects in the sub-sector include the Marine and Coastal Resources Management Project⁵ and the Coral Reef

⁴ ADB. 2003. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to the Republic of Indonesia for the Participatory Irrigation Sector Project*. Manila. Loan 2064/2065-INO, approved on 19 December 2003 for the amount of \$74 million.

⁵ ADB. 2000. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to the Republic of Indonesia for the Marine and Coastal Resources Management Project*. Manila. Loan 1770(SF)-INO, approved on 26 October 2000 for the amount of \$50 million.

Rehabilitation and Development Project Phase II⁶, which apply integrated approaches towards a sustainable management of the coastal and marine resources. Those multidisciplinary marine and coastal resources projects include livelihoods development activities as well as activities aimed at the preservation of the marine resources including coral reefs and mangroves. Through Earthquake and Tsunami Emergency Support Project (Grant 0002-INO) and various JFPR projects, ADB is assisting the Government in rehabilitation of natural resources and related livelihoods and infrastructure, as well as in providing assistance for rational planning for environmentally friendly reconstruction process. Through TA 4551-INO, ADB is also providing technical assistance to the Government for developing its long term strategy and road map for the sector.

376. **Agriculture and Rural Development.** Ongoing loan projects in the subsector include Poor Farmers' Income Improvement through Innovation Project (Loan 1909-INO), which aims to address the constraints faced by the farmers in rainfed and marginal area for enhancing their productivities, broadening their livelihoods and improving their access to services through investments in agricultural research and information systems, extension services, and infrastructure development. Community Empowerment for Rural Development Project (Loan 1765/1766-INO) and Rural Infrastructure Support Project (Loan 2221-INO) also aim at improving the access of rural poor to basic services through provision of village level grants for addressing communities' priority infrastructure related needs. Similarly, the agriculture component of the ongoing Earthquake and Tsunami Emergency Support Project (Grant 0002-INO) aims to revive the agriculture productivity in the affected areas by rebuilding the capacities of the support services, and rehabilitating the farm lands and farming capacities.

10. Proposed ADB Role in the Sector

377. The strategic thrust of sector operation in the short and medium term will focus on revival of growth in the rural economy and management of natural resources in a sustainable manner, with the specific aim to target the poor and disadvantaged section of the community as the main beneficiary, whenever feasible. ADB will be selective in its assistance in the sector, and will concentrate on the strategic areas where it has a distinct comparative advantage. In its assistance ADB will focus on interventions aimed at (i) water resources and irrigation management, (ii) environment and biodiversity conservation, and (iii) rural development.

378. **Water Resources and Irrigation Management.** The Action Plan as detailed in the National Water Sector Profile strikes a balance between water conservation and water use, with recommendations for better spatial planning and improved water resources management plans following sound integrated water resources management approaches. The strategy focuses on sustainability of resources, institutions, and infrastructure, community and stakeholder participation, and social support systems to give beneficiaries a greater sense of ownership. The ADB will priorities assistance at (i) capacity building for implementation and monitoring of compliance with NWL 7/2004 and supporting legislation; (ii) support for human resources development and capacity building in all aspects of water resources development and management; encouragement of joint participation by government, private sector, stakeholders, and WUAs; (iii) continued support for integrated water resources management, and good governance in river basin development and management projects (v) continued support to

⁶ ADB. 2002. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to the Republic of Indonesia for the Coral Reef Rehabilitation and Development Project Phase II*. Manila. Loan 1962, approved on 6 December 2002 for the amount of 33 million.

participatory irrigation development; (iv) implementation of sustainable flood management and strategic spatial planning to minimize flood risk, as well as storage, wetlands, and pollution control; (v) assistance with swamp upgrading support projects and preservation of remaining natural swamp areas; and (vi) development of strategic water resources programs. Proposed ADB activities to support its strategic focus in the subsector include:

- (i) Citarum Integrated Water Resources Management Project will support implementation of strategic road map for development and sustainable management of Citarum river basin following an integrated program. It will help improve quality and supply of water to cities of Jakarta and Bandung and to farmers in West Java.
- (ii) Flood Management in Selected River Basins Project will support the implementation of the Government's integrated river basin management program in four priority river basins in the provinces of Banten, Central Java, Yogyakarta, and East Java.
- (iii) ADTA – Capacity Building in Water Resources in the Decentralized Environment and RETA – Integrated Water Resources Management will both provide crucial support systems for the above mentioned projects through building capacities for holistic management of water resources.

379. Environment and Biodiversity Conservation. Environmental and biodiversity issues are and will continue to be embedded in ADB's integrated river basin management and marine and coastal resource management projects/strategic framework. In the context of the sub-sector, strengthening environmental and natural resource governance, and provision of alternative livelihood activities will contribute to safeguarding the environment and biodiversity. The interventions will be designed in a way that they also address the multiple objectives of poverty reduction, sustainable environmental management, and that they will be meeting the requirements for rural infrastructure in support of enhanced life quality and an enabling environment for economic growth. Local Governments' and stakeholders' capacities to effectively manage natural resources in the long-term will be enhanced. Targeted biodiversity conservation activities shall be carried out, partially with grant financing from the Global Environmental Facility. Proposed ADB activities to support its strategic focus in the sub-sector include:

- (i) Integrated Coastal Resources Management Project (2008) will follow the thrust of ADB's previous and current engagement in this sub-sector and will continue to promote the sustainable management of the marine and coastal resources, hereby introducing best practices in resources management and in coastal development, planning and management at large.
- (ii) Coral Reef Rehabilitation and Management Project Phase III, third and final phase of the ongoing multi-donor initiative at conserving coral reefs, will further facilitate the community management of coral reefs and other priority coastal resources.

380. Agriculture and Rural Development. ADB will support the implementation of RPJM in reinvigorating growth in the rural economy and agricultural production through addressing some of the underlying constraints faced by the sub-sector. In particular, ADB support will have the continued focus on provision of basic rural infrastructure, especially, in the disadvantaged and poor areas. This is an area that directly targets MDG achievement and poverty reduction, and is an area where ADB has demonstrated its comparative advantage. ADB will promote public-private partnership in its support of rural development in the country. ADB's main partners will be MPW, MOHA, and MMAF at the national level and district governments at the implementation levels. ADB will also seek to establish partnership with the World Bank, JBIC, AusAID, and other

bilateral partners that have been active in this area. Proposed ADB activities to support its strategic focus in the sub-sector include:

- (i) Sustainable Aquaculture for Food Security and Poverty Reduction Project will assist the Government in addressing various constraints in aquaculture development in six districts of five provinces of North Sumatra, South Sumatra, West Java, West Kalimantan, and Southeast Sulawesi.
- (ii) TA Enhancing Impact of Rural Infrastructure Development (Attached to RISP II) will help enhance the impact of rural infrastructure through capacity building activities for the EA and district staff in participatory development and improved governance, and mainstreaming improved monitoring and evaluation systems into the Ministry of Public Works.

381. **Crosscutting Themes.** In its operations, ADB will continue capacity building and legal reforms in the sector to support the decentralization process. ADB support in the sector will be characterized by cross cutting activities including; (i) gender and development; (ii) enhancing ecological governance through active participation of community, local government, civil society and other stakeholders; and (iii) maximizing the dissemination of best practices specific to local project context.

11. Links to Overall CSP Outcomes and to Other Sectors/Thematic Areas

382. Outcomes in the sector will directly support the CSP outcomes in the focal areas of environment and natural resources management, MDG acceleration and infrastructure development, which will in turn contribute towards increased rate of economic growth, employment generation and MDG achievement.

12. Opportunities to Address Gender and/or Environment Concerns

383. Gender issues are of particular importance in the sector. Ongoing and proposed interventions will incorporate specific actions to ensure that women are appropriately consulted at the planning stages and are fully involved in implementation of these. The proposed interventions will incorporate measures such as mandatory representation of the women in community level committees responsible for planning, implementation and monitoring of the activities. In addition, gender awareness training will be incorporated into the intervention designs to help ensure that women have equitable access to resources and benefits.

13. Proposed ADB Resource Contribution and Possible Partnerships, including Cofinancing Arrangements

384. Operations in the sector will largely be financed through the ordinary capital resources. However, the components specifically targeting poverty reduction or MDG achievement may also receive financing through ADF or grant fund resources. Indonesia is one of five targeted countries in the Water Financing Program initiative, additional funds have been pledged to support engagement and expand operation in Water. ADB has adequate staff resources to lead the planning, processing and implementation of ongoing and proposed operations, which will be supplemented by consultants with sector specific expertise, where needed.

Table A4.14: Road Map Results Matrix

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators for Sector	Milestone (Tracking) Indicators	Interventions
Development of water resources and related infrastructure for their optimal and sustainable utilization	<p>Increasing water scarcity in Java and Eastern Islands, and competing use between sectors</p> <p>Lack of integrated river basin management</p> <p>Under utilization of existing irrigation infrastructure aggravated by poor condition of some 30% of the irrigation condition</p> <p>Weak coordination, institutions and administration in the sector</p>	<p>Support for establishment of integrated water resources management in priority river basins</p> <p>Investments in irrigation and flood related infrastructure</p> <p>Capacity development for water resources management</p>	<p>Marked increase in production levels in the areas of geographic focus (regional statistical updates)</p> <p>Marked reduction in flood related damages (regional statistical updates)</p> <p>Co-management of water resources and irrigation infrastructure between users and government</p>	<p>Ongoing</p> <p>Participatory Irrigation Sector Project</p>
				<p>Proposed</p> <p>Citarum Integrated Water Resources Management Program</p> <p>Flood Management in Selected River Basins Project</p> <p>Community Driven Irrigation Project</p> <p>Strategic initiatives support for policy development and implementation</p> <p>AOTA – Capacity Building in Water Resources in the Decentralized Environment</p> <p>RETA – Integrated Water Resources Management</p>
Natural resources management done on a more sustainable basis taking into account economic, social and environmental considerations	<p>Inadequate natural resources management capacity at national and local levels</p> <p>Overlapping mandates and functions of Government agencies</p> <p>Low awareness among stakeholders on sustainable resource management</p> <p>Increased pressure on natural resources for livelihoods</p>	<p>Improved management of coastal and marine resources</p>	<p>Integrated management of coastal and marine resources in select districts and provinces</p> <p>Well functioning co-management of coastal resources by communities and local governments in select districts and provinces</p> <p>Well managed coastal and marine protected</p>	<p>Ongoing</p> <p>Marine and Coastal Resources Management Project</p> <p>Coral Reef Rehabilitation and Development Project Phase II</p>
				<p>Proposed</p> <p>integrated Coastal Resources Management Project</p> <p>Coral Reef Rehabilitation and</p>

Medium-Term Development Goals for Sector		CSP Outcomes		
Sector Outcomes for Country	Key Opportunities and Constraints	CSP Outcome(s) and Outcome Indicators for Sector	Milestone (Tracking) Indicators	Interventions
			areas	Development Project Phase III
Reinvigorate growth in rural economy and in agricultural productivities	Lack or inadequacy of basic infrastructure in the rural areas Vast disparities in access to markets and services between geographic regions	Improved welfare and reduced poverty levels in the geographic areas of engagement	Increased coverage levels of physical access, and other basic infrastructure (PODES) Improved operation and maintenance levels (Regional Budgets and PODES)	Ongoing Community Empowerment for Rural Development Project Poor Farmers' Income Improvement through Innovation Project Rural Infrastructure Support Project Proposed Investment for provision and upgrading of infrastructure – Rural Infrastructure Support Project Phases II and III

Source: Asian Development Bank

PRIVATE SECTOR OPERATIONS

A. Private Sector Operations in Indonesia

1. Introduction

1. In order to achieve its vision of a prosperous Indonesia, the Government aims to increase economic growth from 5.5% to 7.6% per annum, complemented by an acceleration of actions and investments to achieve the Millennium Development Goals (MDGs). In its Medium-Term Development Plan (RPJM) the Government identified five key priority areas: (i) job creation and poverty reduction programs; (ii) maintaining macroeconomic stability through stable prices, fiscal sustainability and financial sector reforms; (iii) accelerating investments, exports, and tourism through reforms to create a healthy business climate and flexible markets; (iv) improving access to and the quality of education and health; and (v) infrastructure development by improving the efficiency of existing services and encouraging greater private sector participation.

2. The Asian Development Bank's (ADB) Private Sector Operations Department (PSOD), through its infrastructure (PSIF II) and financial sector (PSCM) divisions, is committed to utilizing its investment and cofinancing products (equity, debt, guarantee, complementary financing scheme [CFS], and technical assistance) to assist Indonesia to mobilize private sector investment in infrastructure and the financial sector in alignment with its priorities as articulated in the RPJM.

2. Private Sector Operations in Infrastructure

a. Overview

3. It is ADB's view that, given recent progress in fiscal consolidation, the Government will be able to increase its investment levels and its first priority should be to invest in infrastructure. For its part, the Government recognizes that a major infrastructure expansion is required to increase services coverage, remove existing bottlenecks, and attract investments that will help achieve and sustain the targeted economic growth. At the outset, investments of 5% of GDP per annum are considered the bare minimum required to restore the pre-crisis levels of infrastructure provision. The Government currently estimates that about \$65 billion will be needed over the 2005–2009 period, with \$25 billion (38%) to be met from the government budget, \$14 billion (22%) by domestic banks and insurance and pension funds, \$10 billion (15%) by multilateral and bilateral donors, and \$16 billion (25%) by domestic and foreign private sector investors.

4. For high levels of economic growth to be achieved, it is a basic requirement that there be adequate investment in energy and transportation infrastructure. In addition, to accelerate progress toward the MDGs, investment in water supply and sanitation infrastructure is essential. ADB's private sector operations in infrastructure will therefore focus on these three sectors. This is also in line with the direction of ADB's Medium-Term Strategy II (MTS II).

5. The Government's recent record of attracting private sector infrastructure investment in the energy, transportation, and water supply and sanitation sectors has been poor. While the regulatory environment for upstream oil and gas field development and gas transportation infrastructure has been strengthened, in the power sector, contractual structures and tendering procedures have discouraged private investors. In the toll road sector, a bankable model

concession agreement has not yet been developed, which has constrained interest among international investors and lenders. This meant projects have been awarded to local companies without the necessary experience or financial resources to carry out the projects. Except for three water supply concessions (two in Jakarta and one in Batam), private sector participation in the water supply and sanitation sector has been insignificant so far.

6. The weak legal framework for land acquisition and resettlement has been another impediment to private sector investment in all sectors and this needs to be addressed urgently. In addition, the lack of creditworthy contractual counterparties in key sectors, in particular the electricity sector, has dissuaded private sector debt and equity capital from investing in support of Indonesia's infrastructure needs.

b. Energy Sector – Hydrocarbons

i. Introduction

7. As shown in Table A4, Indonesia has significant reserves of oil, natural gas, and coal. The country is particularly well-endowed with natural gas resources, with more the 90 trillion cubic feet of proven reserves, the 13th largest gas reserves in the world and the largest gas reserves of any country in Asia and the Pacific.

Table A4: Energy Reserves
(2004)

Energy Type	Units	Quantity	Reserves/ Production Ratio
Oil	Billion barrels	4.72	11.5
Gas	Trillion cubic feet	94.70	34.9
Coal	Million tons	4,968.00	38.0
Anthracite	Million tons	740.00	
Sub-bituminous and Lignite	Million tons	4,228.00	

Source: BP Energy Statistics 2005, Migas.

8. Law No. 22/2001 on Oil and Natural Gas recognized the importance of a certain and transparent legal environment for the oil and gas sector and mandated the establishment of separate regulators for the upstream and downstream sectors. As a result, the supervisory role of the National Oil Mining Company (Pertamina) for the upstream sector was ended. BP Migas, a nonprofit state-owned legal entity, has replaced Pertamina in existing production-sharing contracts and will enter into cooperation contracts with entities undertaking exploration and exploitation of oil and gas in Indonesia.

9. The oil and natural gas law has also removed Pertamina's downstream monopoly and established a downstream regulatory-body-cum-contracting agency, BPH Migas. BPH Migas is authorized to determine and regulate rates for natural gas transmission and distribution through pipelines, to determine and regulate prices to residential and small-scale commercial consumers, to resolve disputes among participants in natural gas transportation activities, and to grant access and tender rights to participate in the natural gas master plan.

ii. Upstream Oil and Gas Production

10. In 2005, because of declining oil production and increasing domestic demand for oil and oil products, Indonesia became the only Organization of Petroleum Exporting Countries (OPEC) member country to be a net importer of oil. It is essential that Indonesia stimulate domestic hydrocarbon production and private sector investment can play a vital role in this process.

11. In view of the benefit to Indonesia's economy of increasing the share of indigenous energy in the country's energy mix, and the environmental benefits of increased consumption of indigenous natural gas, ADB's PSOD is actively looking to support upstream oil and gas production projects. ADB is currently in discussions with Pertamina about the possible financing of the Cepu oil project in East Java. Since the enactment of the new oil and gas law, new production projects are subject to an increased domestic market sales obligation and ADB anticipates that this will give rise to increasing demand for ADB's political risk mitigation products, in addition to direct loan financing. One particular impediment to the financing of upstream gas projects is the fact that many gas projects are designed to sell gas directly to the state electricity utility (PLN). To date, a suitable mechanism for supporting PLN's payment obligations has not been established.

iii. Coal Production

12. The coal production sector is largely in private sector ownership and can be adequately financed from commercial sources, as in the past. There do not seem to be any proposals for significant expansion except to support possible independent power producers and possibly for export. At present, therefore, ADB does not perceive it has a role in the financing of coal production, although opportunities will be considered on a case-by-case basis.

iv. Refining

13. All of Indonesia's eight existing oil refineries, which have a combined processing capacity of 1.05 million barrels per day, are wholly-owned by Pertamina. Because of its insufficient processing capacity, Pertamina currently imports about 400,000 barrels of oil products per day to supplement its own refinery output. In order to increase Indonesia's refining capacity, Pertamina is in active discussions with a number of parties about possible cooperation in the construction of new refinery projects. In May 2006 Pertamina announced a possible joint venture with Kuwait Petroleum Co. and a private Indonesian company to develop a refinery with a capacity of 250,000 barrels per day in Selayar Island, South Sulawesi. In the same month, Pertamina signed a memorandum of understanding (MOU) with Iran's National Iranian Oil Co for the construction of a 300,000 barrel per day refinery project expected to cost \$4 billion to \$5 billion. The project will be located either in Tuban, East Java, or in Banten, Western Java. Discussions with other potential refinery joint venture partners such as Saudi Aramco, Sinopec and the International Petroleum Investment Company (IPIC) are also reported to be ongoing. ADB will consider participating in the financing of refinery projects subject to the development of acceptable credit structures for such projects.

v. Oil Storage

14. The deregulation of the downstream oil and gas sector and the removal of Pertamina's monopoly in retailing of oil products have opened the way for international operators such as Shell and Petronas to enter the oil products retailing market in Indonesia. This in turn has created the need for privately-owned oil storage infrastructure to support the entry of

independent operators. BPH Migas has to date issued two licenses for the operation of such oil storage facilities. ADB's PSOD is in discussions with the private sector developers of a 150 cubic meters per day oil tanking project to be located in West Java.

vi. Gas Transmission and Distribution, including Liquefied Natural Gas

15. The main market for energy in Indonesia is in the island of Java which has fewer gas reserves than Kalimantan, Irian Jaya, and Sumatra, and is therefore dependent on these islands for its supply of natural gas. Major pipeline projects and/or liquefied natural gas (LNG) terminals therefore need to be implemented to bring natural gas to the Java market. PSOD will actively support the implementation and financing of these projects in the private sector. PSOD is currently processing one direct loan, combined with cofinancing, for a total of up to \$150 million to be provided to the State Gas Distribution Company (PGN) on a corporate, non-sovereign guaranteed basis to fund the construction of the South Sumatra to West Java Phase II gas pipeline project. Discussions are ongoing with PGN about the potential financing of future projects, either on a project finance basis or on a corporate basis. PGN is considering joint venture structures, similar to that used for the Transgasindo project for the North Sumatra pipeline which will run from Duri to Medan.

16. PSOD will also look to actively support other gas transmission projects and will actively monitor the Trans Java gas pipeline project, the tender for which was won by Pertamina, and the East Kalimantan to Java pipeline which has recently been tendered by BPH Migas. In addition, ADB will consider financing the construction of gas distribution networks, where these are implemented by PGN or private sector companies.

17. There are a number of LNG projects under development, including the East Java LNG project being developed by PGN and the Padang LNG project in Sulawesi being developed by Pertamina, Medco, and LNGI. On 14 December 2005, ADB approved the Tangguh LNG Project for \$350 million.¹ On 10 August 2006, ADB approved the South Sumatra to West Java Phase II Gas Pipeline Project for \$75 million.

c. Energy Sector – Electricity

18. Indonesia has an existing installed electricity generating capacity of about 25,000 megawatts (MW), of which about 21,800 MW is owned by PLN and about 3,400 MW is contracted from independent power producers (IPPs). In addition there are a large number of captive, mostly diesel power plants,² but these have become expensive to operate following the removal of fuel subsidies. Power demand is projected to grow at an annual rate of 6.6% through 2013.³ To meet the forecast demand, 1,000-2,000 MW of additional generating capacity needs to be commissioned annually. PLN's generation expansion program comprises three projects

¹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors on Proposed Loan to the Republic of Indonesia for the Tanguh Liquefied Natural Project*. Manila, approved on 14 December 2005, for the amount of \$350 million.

² Approximately 10,000 companies maintain their own sources of power, mostly to mitigate the risks of grid supply outages. The combined installed capacity of these captive power plants is estimated at 13,000-15,000 MW, or roughly half of PLN's total capacity.

³ Directorate General of Electricity and Energy Utilization, 2004. *National Electricity Master Plan 2004*. Jakarta. PLN's latest power development plan for 2006-2015 is based on a higher demand growth of 8.5% per annum.

totaling 2,660 MW that will be commissioned in 2006-2007⁴ and eight projects totaling 3,670 MW that are being put up for bidding in a staged manner.⁵ The fact that all these projects except that in Cilegon are to be executed on an IPP basis underlines the importance of private sector participation in meeting Indonesia's power demand.

19. In 2002 a new Electricity Law was enacted in Indonesia (Law No. 20/2002 on Electrical Power). However this law was subsequently annulled by the Constitutional Court and as a result the sector has been in a state of flux. Nevertheless, the Government remains committed to meeting a large portion of Indonesia's demand for power through contracts with IPPs selling power to PLN.

20. ADB is keen to provide support to private sector investors and financiers of power generation capacity in Indonesia through direct project loans or the provision of political risk guarantees. However, because of the weak and deteriorating financial position of PLN, ADB, in common with most other potential lenders, will require that the government provide support for PLN's contractual obligations in respect of new projects. To date the government has been unwilling to provide such support.

21. In power distribution and transmission PLN is planning to fund most of its new investment on a corporate basis and ADB is not currently aware of any private-sector-led projects in these subsectors. If any such opportunities do arise they will be considered for ADB support on a case-by-case basis, subject to the usual criteria of financial and technical feasibility and development impact.

d. Transport Sector

i. Toll Roads

22. The toll road sector has historically been dominated by the public sector. However, the Government has recently reopened toll roads to the private investment, continuing a policy begun in 1995 but stalled by the Asian financial crisis of 1997/98. However recent tenders for new toll roads have not attracted foreign investors or lenders. Most of these projects have been awarded to local companies with little experience and which were not able to obtain the necessary financing. There are two main reasons for this: (i) the concession structure which the Government failed to develop into a bankable model agreement, and (ii) the land clearance needed, which is cumbersome and expensive. PSOD coordinate with ADB's Southeast Asia Regional Department, other donors and developers, to help develop a model concession agreement. While a permanent solution still needs to be found on land clearance, PSOD will identify private sector toll road projects that have already acquired land. A pilot project with a model concession agreement and minimal land issues would encourage the Government to find more permanent solutions to these issues. PSOD will also assist PT Jasa Marga, the state-owned toll road operator, by directly lending on a nonsovereign basis under ADB's innovation and efficiency initiative (IEI) or on a project finance basis to specific projects where PT Jasa Marga is the developer.

⁴ Cilacap in Central Java (600 MW, coal); Cilegon in West Java (740 MW, natural gas, implemented by PLN with JBIC financing); and Tanjung Jati B in Central Java (1,320 MW, coal).

⁵ Cirebon in West Java (600 MW, coal, awarded to a consortium led by Marubeni); Central Java (1,200 MW, coal); Pasuruan in East Java (500 MW, natural gas); Paiton 3 and 4 in East Java (800 MW, coal); Bali (200 MW, coal); Sibolga in North Sumatra (200 MW, coal); Amurang in North Sulawesi (50 MW, coal); and East Kalimantan (120 MW, natural gas).

ii. Light Rail/Urban Transport

23. ADB is aware of only a few urban transport projects under development at present, primarily in Jakarta. Concerns over the quality and commitment of sponsors of these projects and project tendering procedures have meant that ADB has not strongly pursued involvement in any of these projects to date. However, ADB will investigate the potential for supporting projects that have been competitively and transparently tendered to the private sector and for which suitable public-private risk- and cost-sharing arrangements can be established.

iii. Ports and Airports

24. Since these sectors are not accorded a high priority under ADB's medium-term strategy II (MTS II), ADB will be selective in pursuing projects in these sectors and will do so primarily where the projects will have a strong demonstration effect, are innovative and pioneering, and are replicable by ADB and others in Indonesia and elsewhere, or which will significantly facilitate regional cooperation with neighboring countries.

e. Water and Waste Sector

i. Water Supply and Sanitation

25. Among the infrastructure sectors in Indonesia, water supply and sanitation are in the worst technical and financial condition. Only about 35% of the 85 million people living in urban areas are connected to a piped water supply from regional water enterprises (PDAMs). The remainder of the population depends on individual wells, small-scale providers, or water vendors, which are often expensive. In rural areas, the situation is much worse. Only about 15% of rural households receive drinking water from pipe or pump sources, with PDAMs accounting for about half of this. The vast majority of rural households still rely on shallow groundwater extraction or rainwater collection, or use surface water from nearby rivers or springs. Indonesia has one of the lowest rates of urban sewerage coverage in Asia. Only seven cities have some form of sewerage network and only 10% of urban residents are covered. Over 70% of urban households have on-site sanitation, mostly in the form of septic tanks that do not function effectively. It is estimated that annual investments of about \$600 million are required to meet the Millennium Development Goals for water supply and sanitation.⁶

26. Except for three water supply concessions (two in Jakarta and one in Batam), private sector participation in the water supply and sanitation sector has been insignificant so far. ADB will endeavor to support water supply and sanitation projects with private sector involvement where possible.

ii. Waste Management

27. Efforts to date to develop projects in the waste management sector, specifically incineration projects, have been hampered by the fact that government agencies are unwilling to pay tariffs for incineration and projects are generally not viable solely on the basis of power sales revenues and clean development mechanism (CDM) credits. ADB will look to support such projects if changes to the regulatory and financial environment make them viable.

⁶ Halving by 2015 the proportion of people without sustainable access to safe drinking water, and significantly improving by 2020 the lives of at least 100 million slum dwellers through improved sanitation and other measures.

f. State-Owned Enterprise (SOE) Lending

28. ADB's IEI allows ADB to lend without a government guarantee to state-owned enterprises (SOEs) that are creditworthy and have sufficient long-term financial viability. ADB lending to SOEs should be accompanied by corporate and sector reforms. On 10 August 2006, ADB approved a long-term loan to PGN for \$75 million, to be provided on a corporate basis without government guarantee which will be used by PGN to finance part of the cost of the South Sumatra to West Java Phase II gas pipeline project. ADB will consider providing finance on a similar basis to other SOEs which meet the criteria for IEI.

3. Private Sector Operations in the Financial and Capital Markets Sector

a. Introduction

29. Indonesia has slowly been recovering from the profound shocks of the Asian financial crisis of 1997/98, which precipitated a restructuring of both the corporate and banking sectors. At the height of the crisis, an estimated 75% of corporate debt was considered to be nonperforming. Rehabilitation of the banking sector required the closing and/or merging of almost 100 banks, the strengthening of the legal and regulatory framework, and an infusion of Rp430 trillion (US\$47.7 billion) of recapitalization funds from the state budget.⁷ While the financial sector is finally returning to its pre-crisis levels (as a percentage of GDP), it remains vulnerable because of its lack of diversification and the fact that it has only recently adopted international prudential standards. Banks continue to dominate the sector, holding almost twice the market capitalization of the Jakarta Stock Exchange and five times the assets of non-banking financial institutions.

30. State-owned enterprises play a significant role in the banking sector, with an estimated 48% of total banking assets.⁸ Government holdings account for about 32.5% of total Jakarta Stock Exchange market capitalization.⁹ While government ownership of banks has come down from its peak of over 70% in 1999, and further privatizations are planned, the rationale for continued Government minority holdings in several national banks is unclear.

31. The non-bank financial institutions (NBFIs) sector in Indonesia is composed of multifinance companies, mutual funds, insurance companies, pension funds, securities firms, and pawnshops. It remains small, representing only 11% of the total assets of the financial sector. Insurance companies have the largest share of NBFIs assets (32%). Strengthening these institutions will help reduce the private sector's dependence on the banking sector for financial sector intermediation, spur new services and products, and ultimately enhance sustainable economic growth.

32. The Capital Markets and Financial Sector Division (PSCM) of PSOD specializes in the following products: (i) equity (direct and via investment funds); (ii) loans (senior and subordinate), and with respect to capital market projects; (iii) and guarantees (credit enhancement) to foster the creation of securitization and public debt and/or bond markets.

⁷ In total 37 banks were recapitalized, including 4 state banks, 21 private banks and 12 regional banks; a further Rp 220 trillion was injected into BI to support the overall bank recapitalization program

⁸ Calculation based on total assets of the regional and national banks in which the Government has a majority ownership stake and not including the other banks in which the Government has minority shareholdings

⁹ At end 2004.

33. In general, the financial markets and the private sector are dynamic, fast-moving and multi-faceted. They should not be approached with a rigid top-down perspective or with a pre-designed intervention plan. In its current and future operations, PSCM will balance commercial prudence, development impact, and operational efficiency to strengthen the financial sector and financial institutions, which will, in turn, promote sound investment and economic growth, and progress ADB's core mission of poverty reduction.

b. Structured Finance

34. PSCM's structured finance interventions target several key areas: (i) securitization; (ii) nonperforming loan (NPL) resolution financing; (iii) and other structured financing areas (e.g., acquisition financing). In Indonesia, the first two areas, in particular securitization, are currently the main focus of efforts to promote efficiency in capital markets, especially with respect to the development of a well functioning, liquid and deep bond market.

35. The Asian financial crisis has confirmed the need to develop the long-term domestic bond markets in the region. Despite generally high rates of savings, long-term savings have not been efficiently mobilized. Private sector investments in rapidly growing emerging economies have had to be financed with short-term foreign borrowing. To avoid the risk of such mismatches, governments in ADB's developing member countries (DMCs) have been looking for ways to address this issue.

36. There are several benefits to the development of the securitization market. First, the development of the bond and securitization market would reduce the problem of credit tightening, as it would release the scarce capital of the Indonesian banks and other financial institutions, enabling new lending. Second, given the increased competitiveness and consolidation process in the financial and corporate sectors, securitization would allow banks and finance companies to increase their returns by redeploying the same equity. A financial institution could extend loans at market rates, and then securitize a pool at a lower rate because of diversification and the efficiencies inherent in tranching cash flows. With financial institutions becoming more conscious of the cost of capital and more aware of the need to diversify their sources of funding, securitization of loan portfolios would become a core tool of balance-sheet management. Third, securitization would offer the financial institutions a new intermediary role by redistributing credit risk in the same way as an insurance provider pools individuals' exposures to losses or accidents. Under the traditional model, banks performed this by matching pools of borrowing with pools of deposits. In securitization, they package credit for capital market investors rather than depositors.

37. Securitization offers an effective way of improving the capital adequacy of the banking and financial sectors, both of which are critical elements in improving the overall performance of the Indonesian financial sector. The development of the securitization market will aid in the growth and development of the corporate bond market, in particular the following.

- (i) **Credit rating culture.** Based on international past precedents, an independent credit rating system is a key component in the development of a corporate bond market that functions well. Only when investors have comfort in an independent rating system will they be able to properly assess the true credit risk in corporate and other bonds.
- (ii) **Credit pricing process.** Securitization issuance will also develop a credit pricing curve. Securitization results directly in the sophistication, consistency, and transparency of the credit pricing process.

- (iii) **Increasing the number of institutional investors.** With the growth of the securitization market, more institutional investors will come to Indonesia, serving to enhance competition and increase liquidity for the market as a whole.
- (iv) **Diversification for investors.** Securitization issuance and the supply of a wide range of new financial assets will enable institutional investors to create stable, diversified asset portfolios that offer them a better chance of achieving their return and risk management objectives.

38. With respect to securitization transactions in Indonesia, ADB will follow three main business lines: (i) participating in the establishment of a securitization vehicle with standardized documentation, which can be used by many originators across Asia;¹⁰ (ii) guaranteeing the senior tranche or purchasing a mezzanine (subordinated) tranche of asset-backed securities (issued in a securitization); and (iii) providing a liquidity facility or other credit enhancements to securitizations or other structured transactions (such as credit linked notes). In order to implement this strategy, PSOD has entered into discussions with a selected group of international banks. The first such transaction under the second strategy, the securitization of two portfolios of motorcycle loans by the Jakarta branch of Deutsche Bank AG from PT Summit OTO Finance in Indonesia, was approved by the ADB Board on 26 July 2006.¹¹ It included a guarantee of \$9.8 million and an equity investment of \$200,000. Once this pilot transaction has been successfully implemented, Deutsche Bank AG and ADB plan to replicate the structure in other transactions.

c. Investment Funds

39. The primary objective of ADB's investment funds operations is to catalyze foreign and domestic investment into long-term finance. There is still a gap in long-term equity finance for many companies in ADB's DMCs, especially for small and medium-sized enterprises (SMEs), because foreign direct investment (FDI) is often targeted directly at local subsidiaries of multinational corporations, while other equity investors focus on short-term investments in publicly listed companies. Collateral-based lending is the norm among banks, which automatically limits access to finance for most SMEs unless they can tap into long-term equity finance, which enables them to leverage their expansion capabilities and to raise additional debt financing.

40. Private equity investments, channeled through ADB's investment funds, can play an important role in the graduation of SMEs to larger enterprises for several reasons.

- (i) Fund managers that invest on behalf of private equity investors participate in the upward potential and the downward risks of their investee companies, which implies that their interests are closely aligned with the progress of these companies. Therefore, they have an incentive to select those companies with the most promising potential for entrepreneurial growth and to enhance the value of their investees.
- (ii) Fund managers undertake a variety of functions to foster the growth of their portfolio companies, such as helping to recruit key personnel and providing

¹⁰ Similar to the model set up by Kreditanstalt für Wiederaufbau in Germany ("Promise and Provide").

¹¹ ADB. 2006. *Report and Recommendation of the President to the Board of Directors for Financing and Partial Credit Guarantee Acquisition and Securitization of Motor Loan Portfolios by Deutsche Bank AG*. Manila, Loan 7239-INO, approved on 26 July 2006, for the amount of \$10 million.

- strategic advice, developing their investee companies' governance structure, and introducing new customers.
- (iii) Private equity investors can use their networks to launch new firms, and achieve spin-offs and expansions when they perceive an entrepreneurial opportunity. In this role, they can accelerate the rate of business formation and economic development.
 - (iv) Private equity investments play a critical role in the economic growth process by diversifying the sources of finance available for SMEs. The inclusion of equity finance enables entrepreneurial SMEs to buy fixed assets and to use them as collateral for commercial bank loans to leverage their expansion. This leverage effect creates a dynamic process that promotes SMEs' graduation to larger enterprises, which results in increased employment and productivity.

41. The private equity industry's activities in Indonesia were halted abruptly during the Asian financial crisis, but they have gradually begun to recover in recent years. Formally, there were 26 regional venture capital firms, 20 private firms and 14 joint-venture firms as of June 2003. However, they recorded assets of only \$240 million and investments of \$164 million in 2002 according to the Ministry of Finance. In 1999, the Indonesian Government set up a new state-owned holding company, Independent Investment Capital Corporation(PNM). The institution, with a paid-up capital of \$36 million, aims to spur the development of cooperatives and SMEs by injecting equity into domestic companies. All in all, the total venture capital pool deployed through official funds remains marginal relative to the economy and the private sector risk capital industry has not recovered its size or rate of growth since the crisis.

42. In Indonesia, ADB helped to catalyze long-term investment to the country when it invested in the Aureos South-East Asia Fund in 2005. The fund, with ADB's support, will demonstrate the credibility of private equity in the Association of Southeast Asian Nations (ASEAN) region, including Indonesia. This demonstration effect is best achieved by support to domestic private equity teams capable of showing that private equity investments in Southeast Asia can realize investor value through organic growth of SMEs. Therefore, capacity building of local investment teams is a major objective of this fund.

43. The fund will demonstrate the credibility of private equity in Indonesia where the private equity industry is still well below the levels of the Republic of Korea and Singapore.¹⁰ Like the private equity industries in Republic of Korea; Singapore; and Taipei, China during the 1980s, catalytic investments in private equity funds in Indonesia have the potential to foster local management capacity and to demonstrate to the private sector that investments in entrepreneurial SMEs can generate sufficient returns.

44. PSOD intends to continue investing in regional private equity funds that include Indonesia as an investment destination and that have a clear established track record and investment focus. Several such interventions are currently being reviewed.

¹⁰ The private equity investment rate as a share of GDP in 2003: 0.59% in Singapore, 0.47% in the Republic of Korea, 0.31% in Indonesia. *Venture Capital Journal*. 2004. "The 2004 Guide to Venture Capital in Asia." Hong Kong, China; World Bank. 2004. *World Development Indicators*. Washington, DC.

d. Financial Institutions

45. ADB follows two different approaches to its work with banks, insurance companies, nonbank credit companies, leasing companies, exchanges, and depositories. First, it aims to develop the financial sector to improve mobilization of savings and extension of credit. Efficient and effective financial intermediation through financial institutions is an essential requirement for private sector development and economic growth. Second, it aims to deliver ADB funds through financial institutions to medium-sized, small and micro borrowers that cannot efficiently be reached directly by ADB's operations. This approach makes use of the financial institutions' local market knowledge and infrastructure.

46. Financial institution interventions are conducted through ADB's public and private sector windows. Interventions may include:

- (i) creating an enabling environment (e.g., regulation, supervision, capacity building, and financial infrastructure);
- (ii) resolving specific problems in particular institutions with (e.g., restructuring, recapitalization, and privatization);
- (iii) filling market gaps through the creation of new institutions (e.g., specialized lenders, exchanges, credit ratings agencies, credit information centers, depositories, and giro systems);
- (iv) providing regulatory capital (e.g., equity, subordinated debt, and other capital instruments) to key institutions to support capital ratios and asset expansion;
- (v) providing funding (e.g., additional liquidity, longer tenors, foreign currencies) to key institutions to expand assets and improve asset–liability management; and
- (vi) targeted on-lending programs to priority sectors such as SMEs, agriculture, infrastructure, housing, trade finance (e.g., debt facilities and partial credit guarantees).

47. There are many opportunities for intervention through ADB's private sector window under points (ii) to (vi) above. PSCM can also make a contribution to the policy dialogue under point (i). Interventions can take the form of lending (e.g., loans and bonds), equity investments, hybrid instruments (e.g., preferred stock, subordinated debt, convertible debt), partial credit and political risk guarantees (and other appropriate instruments). In all cases the basis of an intervention is (i) a general "needs assessment" and (ii) a specific opportunity to intervene. Debt provision is on market terms, but ADB enters niches and underserved markets or bridges the gap with respect to maturities and structuring.

50. In particular, PSOD will explore the provision of a financial intermediation loan to a local SME bank or to a non-bank finance company catering to SMEs (i.e., leasing company). The main targeted beneficiaries of this intervention would be SMEs without prior access to external finance, or SMEs that are already borrowing but require larger and longer-term loans. The SME sector represents approximately 57% of the economy and approximately 60% of the labor force. ADB also aims to expand its cofinancing operations in Indonesia, especially its guarantee operations, which is line with the medium-term strategy II. One focus will be on providing credit guarantees in support of capital markets, i.e., to guarantee the issue of securities, including corporate issues or asset-backed securities.

COST-SHARING CEILING AND OTHER FINANCING PARAMETERS

Item	Parameter	Remarks/Explanation
Country Cost Sharing Ceiling <i>for the loan portfolio over the period of the CSP, 2006–2009</i>	Up to 70%	This represents a continuation of current practice. Ownership and commitment will be developed through the budgetary allocation process, and will allow the oversight agencies to ensure that projects are properly prepared and implemented. Depending on the nature of the project and needs, percentages can vary for each project.
Country Cost Sharing Ceiling <i>for the TA portfolio over the period of the CSP, 2006–2009</i>	Up to 80%	This represents a continuation of current practice. The Government routinely allocates a budget for its 20% of TA projects, which promotes ownership and commitment.
Cost Sharing Ceiling <i>for all sectors for the loan portfolio over the period of the CSP 2006-2009</i>	Up to 70%	Sector specific variations have not been proposed.
Recurrent Cost Financing. <i>Do any limits apply to the overall amount of recurrent expenditures that ADB may finance?</i>	No country limit other than the cost sharing ceilings.	The Government has moved to a unified budget system, where there is no longer a distinction between recurrent and non-recurrent expenditures. Officially, project implementation units no longer exist, although the phasing out will take some time. Therefore, projects will become fully integrated into the Government system during implementation, increasing the chances of sustainability.
Taxes and duties. <i>Are there any taxes and duties that ADB would not finance?</i>	None	Taxes and duties are considered reasonable, and there are no taxes and duties specifically targeted at ADB projects. At the project level, ADB would consider whether taxes and duties constitute an excessively high share of project costs. The Government has indicated that it would generally not consider borrowing for taxes and duties.

CSP = Country Strategy and Program; TA = Technical Assistance
Source: Asian Development Bank

CONCEPT PAPERS FOR LENDING PRODUCTS

This appendix contains the concept papers for the following lending products:

Table A7.1: Sustainable Aquaculture for Food Security and Poverty Reduction

Table A7.2: Madrasah Education Development Project

Table A7.3: Development Policy Support Program (DPSP) II and III

Table A7.4: Infrastructure Development Program (IRP) Program Cluster

Table A7.5: Interisland Ports

Table A7.6: Integrated Citarum Water Resources Management Project

Table A7.7: Senior Secondary Education Development Project

Table A7.8: Improving Efficiency of Energy Distribution and End Use

Table A7.9: Financial Governance and Social Security Reform Program (FGSSR) II and III

Table A7.10: Secondary Mortgage Facility

Table A7.11: Nutrition Improvement Through Community Empowerment (NICE) Project

Table A7.12: Poverty Reduction and MDG Acceleration Program

**Table A7.1: Sustainable Aquaculture for Food Security and Poverty Reduction
Concept Paper**

Date: 7 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other:</p> <p><input type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sectors: Agriculture and natural resources Subsector: Fisheries</p> <p>b. Targeting classification</p> <p> <input checked="" type="checkbox"/> Targeted intervention</p> <p> <input type="checkbox"/> General intervention</p> <p>c. Key thematic areas</p> <p> Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p> Subthemes: Promoting economic efficiency and enabling markets, fostering physical infrastructure development, public–private partnerships</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Agriculture, Environment, and Natural Resources Division, Southeast Asia Department</p>								
<p>5. Responsible ADB officer: M. Jamilur Rahman</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: Indonesia has an abundance of freshwater, brackish water, and marine resources with potential for aquaculture development. It has a large variety of cultivable fish and other aquatic species and the available technology for aquaculture in fresh, brackish, and marine environments. Aquaculture has been increasingly significant in ensuring food availability, providing household food security, generating valuable foreign exchange and domestic revenues, boosting exports of fish and aquatic products, and improving the living standards of poor rural communities. However,</p>								

aquaculture development has been constrained by (i) low growth and productivity resulting from poor fish-farming systems and lack of quality fish and shrimp seed; (ii) environmental degradation and pollution resulting from poor fish-farm management and technology; (iii) lack and inaccessibility of credit for poor or small-scale fish farmers; (iv) high costs of imported production inputs; (v) absence of social preparation, inefficient extension services, and lack of postproduction facilities and marketing infrastructure, particularly for use by small farmers; and (vi) conflicts in water use in open water areas between fish farmers and other users. The project will help the Government address these issues.

- b. Goal and purpose:** The development goal is to reduce poverty and ensure food security through sustainable aquaculture development. The specific objectives are (i) to increase the production of fish and other aquatic products from aquaculture; (ii) to improve the income, nutrition, and employment status of poor fish farmers and coastal communities; and (iii) to protect the environment in inland and coastal water areas.
- c. Components and outputs:** (i) Aquaculture production enhancement, to improve the performance of the major types of aquaculture systems in the project area through community-based management; (ii) aquaculture support services, to upgrade production techniques and quality of aquaculture products by strengthened extension services and improved postharvest handling, processing, and marketing techniques in collaboration with the private sector and community-based organizations (CBOs); and (iii) institutional strengthening and project management, to enhance the institutional capability of the Directorate General of Aquaculture, district fisheries services, fish farmers, CBOs, and the private sector in aquaculture development, including enterprise planning, management, regulation, and operation.
- d. Rationale and purpose of ADF grant financing:** Not applicable.
- e. Expected results and deliverables:** The project will reduce poverty by boosting incomes, employment, and food security. It is expected to increase food and nonfood expenditures and fish consumption by 20% and help 20,000 poor households rise above the poverty line.
- f. Social or environmental issues or concerns:** The project aims to increase incomes by removing infrastructure, technological, environmental, and market-access constraints on poor fish farmers. It will be implemented in a fully participatory manner with most of the aquaculture and culture-based fisheries activities to be directly implemented by communities.

Project interventions are not expected to have significant or adverse impacts on the environment. Environmental safeguards have been built into project design.

- g. Plans for disseminating results/deliverables:** The project will establish a market information system to enable fish farmers, CBOs, and private enterprises to gain access to real-time data on market prices, supply and demand, and other market-related information for various aquaculture products. To increase the consumption of freshwater fish, a multimedia marketing campaign will be launched in the project provinces. The project will provide for national and international workshops and seminars to ensure that the experiences and lessons learned through the project are widely available for future interventions.

7. Proposed executing/implementing agency or agencies: The Directorate General of Aquaculture, Ministry of Marine Affairs and Fisheries as executing agency; and participating local governments as implementing agencies

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: The project has been designed in close cooperation with the executing agency and all participating districts.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2001
- b. Expected date of submission for approval
 Lending: November 2006
 Nonlending:
- c. Period and duration of assistance
 Lending: 1 July 2007–30 June 2013 (6 years)
 Nonlending:

10. Financing Plan

- a. For lending
- Ordinary capital resources:
 - Asian Development Fund (loan): \$40 million
 - Asian Development Fund (grant):
 - Other:

Source	Amount (\$ million)
ADB Financing	40.00
Government Financing	10.19
Other Financing (beneficiaries)	3.07
Total Cost	53.25

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.2: Madrasah Education Development Project
Concept Paper**

Date: August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input checked="" type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input checked="" type="checkbox"/> Other: Advisory TA for external monitoring and evaluation</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the</p> <p> Sector: Education</p> <p> Subsectors: Basic education, senior secondary general education</p> <p>b. Targeting classification {check one}</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p> Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input checked="" type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p> Subtheme: Human development</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Social Sectors Division, Southeast Asia Department</p>								
<p>5. Responsible ADB officer(s): W. Duncan</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: The main thrust of the ADB education strategy is to support the Government's goal of good quality basic education for all children by 2009, within the framework of the national education system. Central to this concept of a national education system are the Governments' partnerships with private providers of education, including community groups running private schools and religious groups running madrasah. To optimize the partnership with the madrasah education sector and ensure equity for all students regardless of which school system they attend, it is critical that the madrasah are brought up to the same quality standards as the mainstream public schools.</p>								

<p>b. Goal and purpose: The impact of the project will be an increased competitiveness of madrasah graduates, evidenced by more and better-performing graduates from senior secondary madrasah, more madrasah graduates in the top universities, especially women, and higher wages for graduates. The project outcome will be improved Improved quality of madrasah education at primary, junior secondary and senior secondary levels, resulting in improved learning outcomes for grades 6 and 9 in core subject areas; raised accreditation levels for project madrasah; and enhanced perceptions of madrasah education quality among stakeholders.</p> <p>c. Components and outputs: The project will help project madrasah meet or exceed national education standards for (i) teacher professionalism; (ii) teaching–learning resources and facilities; (iii) internal efficiency; and (iv) governance, management, and sustainability. The project will target most of its resources toward school improvements by offering qualification training for teachers; upgrading classrooms, libraries, and science laboratories; and making available teaching and learning materials for students and teachers. The project will enhance internal efficiency of the project madrasah by increasing transition rates from primary to junior secondary level, reducing dropout and repetition rates, and raising completion rates at all levels through remedial and scholarship programs, particularly for disadvantaged poor and female students. Governance, management, and sustainability of project madrasah will be improved through performance-based development planning and management, including greater transparency in financial management and accountability, and implementing information and advocacy programs to encourage resource mobilization by project madrasah to enhance their sustainability.</p> <p>d. Rationale and purpose of ADF grant financing: Not applicable</p> <p>e. Expected results and deliverables: Raised accreditation levels for project madrasah, better learning outcomes for students, and enhanced community perceptions of madrasah quality.</p> <p>f. Social or environmental issues or concerns: None</p> <p>g. Plans for disseminating results/deliverables: National workshops will be held regularly to discuss project progress and outputs. Positive results will be disseminated throughout project districts and provinces to highlight good practices and raise the social image of madrasah education.</p> <p>For TA, method(s) of TA output dissemination:</p> <p><input checked="" type="checkbox"/> A conference/workshop/brown bag</p> <p><input type="checkbox"/> Publication of articles in external journals or books</p> <p><input type="checkbox"/> External press release to news agencies, including www.adb.org</p> <p><input type="checkbox"/> Internal press release in <i>ADB Today</i></p> <p><input checked="" type="checkbox"/> Others external monitoring and evaluation reports.</p>
<p>7. Proposed executing/implementing agency or agencies: Ministry of Religious Affairs (MORA)</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:</p> <p>Madrasah owners and operators were consulted extensively through field work during the project preparatory TA, and attended national workshops, including the midterm and final tripartite reviews. MORA worked closely with the TA team through a technical team set up by MORA for that purpose. The team consisted of MORA staff members as well as three external experts advising MORA on education issues.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2004</p> <p>b. Expected date of submission for approval</p> <p style="padding-left: 20px;">Lending: 2006</p> <p style="padding-left: 20px;">Nonlending (project preparatory):</p> <p style="padding-left: 20px;">Nonlending (other than project preparatory): 2006</p> <p>c. Period and duration of assistance</p> <p style="padding-left: 20px;">Lending: Jan 2007-Dec 2011</p> <p style="padding-left: 20px;">Nonlending: Jan 2007-Dec 2011</p>

10. Financing Plan

a. For lending

- Asian Development Fund (loan): \$50 million
- Asian Development Fund (grant):
- Other:

If cofinancing is required, indicate amount and sources sought: \$15 million, from AusAID

Source	Amount (\$ million)
ADB Financing	50,025
Government Financing	21,404
Other Financing	-
Total Cost	71,429

Source: Asian Development Bank estimates.

b. For nonlending

- No resources required, other than ADB staff
- ADB's administrative budget:
- Grant TA funds \$1 million
- Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

Source	Amount (\$)
ADB Financing	
Government Financing	
Other Financing	
Total Cost	

Source:

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.3: Development Policy Support Program (DPSP) II and III
Concept Paper**

Date: 3 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input checked="" type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other</p> <p><input type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Law, economic management, and public policy Subsector(s): National government administration</p> <p>b. Targeting classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subthemes: Public governance, institutional development.</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Indonesia Resident Mission/Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer(s): R. Subramaniam</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: The proposed Development Policy Support Program (DPSP) II is embedded in the Government's Medium-Term Development Plan (RPJM) for 2004-2009. ADB supported the implementation of critical investment climate and public financial management reforms through the first phase of DPSP—which cofinanced the Development Policy Loan (DPL) 2 of the World Bank—in 2005. DPSP-II will build on that support, and help achieve the RPJM's broad goal of stimulating sustainable economic growth (to 7% average annual outcome by 2009, up from around 4% before 2004), and halving poverty to 8.2% by 2009 from 16.6% in 2004. During February-June 2006, the Government has formulated (i) the Infrastructure Policy Package (IPP) to accelerate public and private investments, (ii) the Investment Climate Reform Package to strengthen the overall investment environment, and (iii) the Financial Sector Reform Package (FSRP) to strengthen and deepen the banking and nonbank financial sectors. In addition, the Small and Medium-Sized Enterprise Reform Package is under preparation. ADB plans to provide dedicated sector support to help implement the IPP (through the proposed Infrastructure Reform Program Cluster) and the FSRP (through the</p>								

<p>proposed Financial Governance and Social Security Reform Program Cluster). The DPSP series supports cross-cutting macroeconomic reform measures to improve the overall investment environment and stimulate public and private investments. All of these areas are closely linked to ADB's proposed country strategy.</p> <p>b. Goal and purpose: The program aims to achieve and sustain higher economic growth through (i) improved investment climate and creditworthiness; (ii) better public financial management; and (iii) strengthened service delivery to the poor, which, in turn, will help distribute resources equitably and promote growth.</p> <p>c. Components and outputs: Each single-tranche program loan under the DPSP series (i.e., DPSP-I approved in December 2005, and the proposed DPSP-II) has four core policy areas (CPAs), in line with the DPL series of the World Bank. These include (i) CPA-1: macroeconomic stability and creditworthiness; (ii) CPA-2: improved investment climate; (iii) CPA-2: improved public financial management and anticorruption framework; and (iv) CPA-4: improved delivery of public services. The focus of CPA-1 is to strengthen fiscal policy formulation and implementation, improve debt management, and streamline the regulatory framework for onlending and on-granting to ensure that development spending is maintained at adequate levels in the decentralized districts and subdistricts. CPA-2 focuses on strengthening the overall regulatory framework for investment approvals, improving tax administration, and enhancing financial system stability. CPA-3 aims to strengthen budget execution and reporting, and CPA-4 supports the Government in monitoring pro-poor programs.</p> <p>e. Expected results and deliverables: DPSP is expected to result in greater macroeconomic stability as demonstrated by budget deficit contained below 1% consistently throughout the RPJM period, and public debt reduced to levels below 45%. On the investment front, the DPSP series is expected to lead to an increase in the share of investments to GDP by 3–5% points. The program will also result in all core Government cash operations consolidated in to a Treasury single account (TSA).</p> <p>f. Social or environmental issues or concerns: By supporting improvements in the delivery of public services, DPSP series will help the Government improve social stability and effectively cushion the inflationary impact of fuel price increases. No environmental issues or concerns are foreseen under the DPSP series.</p> <p>Plans for disseminating results/deliverables: This will be done through the Government's own consultation process for the various policy packages mentioned above.</p>
<p>7. Proposed executing/implementing agency or agencies: Coordinating Ministry of Economic Affairs (CMEA); and Ministry of Finance (MOF), Ministry of Home Affairs (MOHA); and Bank Indonesia (BI)</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: The Government has formulated a number of policy packages that form the basis for the DPSP. It has been a firm driver of the overall reform agenda supported under the development policy loans of the World Bank from 2004 (cofinanced by ADB through DPSP since 2005). In particular, it has shown fullest commitment in developing the forward-looking triggers since 2004.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006</p> <p>b. Expected date of submission for approval Lending: November 2006 [to be followed by DPSP-III envisaged in 2007] Nonlending (project preparatory): Not applicable Nonlending (other than project preparatory): Not applicable</p> <p>c. Period and duration of assistance(s) Lending: 2006 Nonlending: Not applicable</p>
<p>10. Financing Plan</p> <p>a. For lending</p> <p><input checked="" type="checkbox"/> Ordinary capital resources: \$200 million</p> <p><input type="checkbox"/> Asian Development Fund (loan):</p> <p><input type="checkbox"/> Asian Development Fund (grant):</p> <p><input type="checkbox"/> Other:</p>

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.4: Infrastructure Reform Program (IRP) Program Cluster
Concept Paper**

Date: 3 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input checked="" type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other</p> <p><input type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Multisector Subsector(s):</p> <p>b. Targeting classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme(s): Fostering physical infrastructure development, public–private partnerships, promoting economic efficiency and enabling markets</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Indonesia Resident Mission/Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer(s): R. Subramaniam, Principal Economist, Indonesia Resident Mission.</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: Combined public and private sector investments in infrastructure exceeded 5–6% of gross domestic product (GDP) in the mid-1990s. The Asian financial crisis of 1997 led to a steep decline in overall development spending, and particularly infrastructure investments. Private sector investments have almost dried up from 1998 onward. At the same time, the Government also realized that the public sector had borne a disproportionate share of the risks in infrastructure, and stopped providing any risk-sharing support. As a result, post-crisis, Indonesia lost its place as one of the top performers in infrastructure provision in Southeast Asia. With infrastructure investments at around 2% of GDP since 1998, there are still about 50 million people (or more than 20% of the population) without access to treated water, 90 million people without electricity, and about 200 million people without fixed telephone lines or connections to a sewerage network. It is the poor who suffer disproportionately from the lack of access to such basic infrastructure services.</p>								

The availability of services is generally lower in rural areas, particularly those outside Java and Bali, contributing to significant regional disparities in development. The Government estimates that about \$65 billion will be needed in new infrastructure investments over the next 5 years, with \$25 billion (38%) to be met from the Government budget, \$14 billion (22%) by domestic banks and insurance and pension funds, \$10 billion (15%) by multilateral and bilateral donors, and \$16 billion (25%) by domestic and foreign private sector investors.

The Government recognizes that private sector participation (PSP) cannot be taken for granted, unless serious structural and institutional reforms are implemented, given the weak investment climate. In January 2005, the Government held the Indonesia Infrastructure Summit where it announced its commitment to promote PSP and identified 91 potential infrastructure projects. Since then the Government has taken several critical measures to strengthen the legal and institutional framework for PSP. It adopted the comprehensive Infrastructure Policy Package in mid-February 2006, outlining the reform agenda in the various infrastructure sectors. The proposed IRP, formulated at the Government's request, is based on this policy package, which was developed in consultation with a range of stakeholders and development partners, including ADB. The IRP aims to support infrastructure reforms during 2005-2009, in line with the Government's Medium-Term Development Plan.

- b. Goal and purpose:** The objective of the proposed IRP is to enhance infrastructure provision and access and thereby strengthen the investment climate, which will help realize the Government's medium-term macroeconomic goals, particularly in achieving an average annual GDP growth of 6–7% during 2005–2009. The expected outcome of the IRP is accelerated infrastructure development through large-scale PSP and increased public sector spending.
- c. Components and outputs:** The IRP Program Cluster Concept comprises three back-to-back subprograms to support infrastructure reforms during 2005–2009. Subprogram 1 (SP1) is envisaged to be considered by ADB Board in September 2006. An interval of about 14–18 months is envisaged between each subprogram. Subject to adequate progress and approval of SP1 by the Board by September 2006, SP2 would be brought for the Board's consideration and approval by the first quarter of 2008, while SP3 would follow in 2009. The overall IRP Program Cluster has three key reform pillars:
- (i) **Strategic cross-sectoral reforms**, resulting in the following:
 - (a) improved policy, legal and institutional framework for greater PSP that is anchored on good governance principles;
 - (b) well-structured risk management framework that promotes PSP;
 - (c) accelerated mobilization of domestic long-term financial resources for infrastructure development through public private partnership (PPP) projects; and
 - (d) streamlined regional autonomy framework, clearly delineating functional responsibilities between the national and local governments in infrastructure provision.
 - (ii) **Sector-specific policy, legal and institutional reforms in transportation; power; oil and gas; water supply and sanitation; and telecommunications sectors** leading to the following:
 - (a) improved financial soundness and sustainability of infrastructure services through full cost recovery;
 - (b) greater competition that benefits the consumers through improved services and lower tariffs;
 - (c) independent regulatory structures that are distinct from contracting and operating functions;
 - (d) a level playing field between different actors, and the prevention of abuse of natural monopoly rights; and
 - (e) fulfillment of the public service obligations of infrastructure service providers, in line with the Government's poverty reduction objectives.
 - (iii) **Preparation and implementation of well-structured project transactions**, resulting in sound model PPP projects that can be replicated.
- d. Expected results and deliverables:** The implementation of the IRP program cluster is likely to significantly accelerate public and private investments in infrastructure. By 2009, the program cluster will help the Government boost the ratio of infrastructure investments from 2% of GDP now to 5% by 2009. In addition, at least about 40 sound PPP projects will be processed for bidding, in turn generating \$20 billion in new investments by 2009.
- e. Social or environmental issues or concerns:** By scaling up infrastructure provision, the IRP program cluster will accelerate growth, improve the investment environment, and create jobs. ADB's program loan proceeds will

<p>not be used to finance actual investments in projects. However, the Government's own environmental standards and guidelines will be adopted in the design and implementation of the model PPP projects supported under the IRP program cluster.</p> <p>Plans for disseminating results/deliverables: This will be done through the Government's own consultation and dissemination process for the infrastructure policy package.</p>
<p>7. Proposed executing/implementing agency or agencies: The National Development Planning Agency (BAPPENAS) will act as the executing agency for the IRP program cluster. The implementation of the program cluster will be overseen by the National Committee on the Acceleration of Infrastructure Development (KKPPI). The Coordinating Ministry of Economic Affairs (CMEA), Ministry of Finance (MOF), various infrastructure line ministries (including the ministries of transport, public works, energy and mineral resources, and communications), and a number of contracting agencies in infrastructure will implement the various components.</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: The Government fully owns the IRP program cluster. As the IRP is anchored on the Government's infrastructure policy package, it has the backing of the oversight ministries and all the concerned line ministries and agencies. The Government has been fully involved in formulating the reform agenda supported under the IRP.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006</p> <p>b. Expected date of submission for approval Lending: SP1 of IRP in September 2006; SP2 in the first quarter of 2008; and SP3 in the second and third quarter of 2009 Nonlending (project preparatory): Not applicable Nonlending (other than project preparatory): SP1 includes a \$1.8 million TA to enhance private sector participation in infrastructure provision.</p> <p>c. Period and duration of assistance Lending: 2006-2010 Nonlending: 2006-2010</p>
<p>10. Financing Plan</p> <p>a. For lending</p> <p><input checked="" type="checkbox"/> Ordinary capital resources: The Government has requested \$400 million for SP1. The single-tranche programs under SP2 and SP3 are tentatively estimated at \$300 million each.</p> <p><input type="checkbox"/> Asian Development Fund (loan):</p> <p><input type="checkbox"/> Asian Development Fund (grant):</p> <p><input type="checkbox"/> Other:</p>

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.5: Interisland Ports
Concept Paper**

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input checked="" type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Transport and communications Subsector: Ports, waterways, and shipping</p> <p>b. For project preparatory and lending, classification</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input type="checkbox"/> General intervention</p> <p>c. Key thematic areas</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td></td> </tr> </table> <p>Subtheme(s): Fostering physical infrastructure development</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development								
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input checked="" type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Infrastructure Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: J. Miller</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: Sea transport is important in eastern Indonesia, particularly for moving cargo, despite the declining role for passenger transport because of competition from air transport. Port infrastructure development in the main logistics corridor is needed to plan the port hierarchy to strengthen the logistics chain in eastern Indonesia. Port expansion is also required to improve port productivity and efficiency, and to accommodate the growing demand for transport. However, the physical development will only be effective if the Government also addresses (i) the institutional, legal, and regulatory framework, including port tariffs determination and adjustment mechanisms to promote private sector involvement in port investment and operation; (ii) the port security system; and (iii) sea transport and port sector reform, particularly</p>								

providing clear guidelines for the Government, port operators, regional governments, and the private sector role in developing and financing ports, and optimizing ferry and sea transport operation.

The existing ports of Balikpapan and Jayapura cannot handle the current and long-term predicted container throughput. At the macro level, the development of Balikpapan and Jayapura ports was recommended under the ADB TA to prepare the Interisland Transport Project. The Balikpapan Port subproject is of priority as (i) it will enhance the northern logistics corridor ports, and (ii) Balikpapan city is designed as the growth pole for the Samarinda–Balikpapan integrated economic development zone, as well as a BIMP-EAGA port. Jayapura port development is deemed necessary as it (i) plays an important role for the northern, central, and southern logistics corridor; and (ii) will support a sea linkage to Sorong port as an important gateway to Papua province. The project will significantly contribute to enhancing ADB's strategic focus of assistance for Indonesia.

- b. Goal and purpose:** The primary objective is to (i) increase sea cargo mobility, (ii) increase port performance and productivity by expanding and modernizing port infrastructure of Balikpapan and Jayapura ports, and (ii) improve the port business environment. The project will help implement the Government's strategy in enhancing the sea transport subsector and stimulating economic growth in eastern Indonesia.
- c. Components and outputs:** The project comprises four components: (i) port development, (ii) port sector reform, (iii) capacity building and training, and (iv) TA for Banjarmasin port. The port development component consists of the construction and extension of Balikpapan and Jayapura ports, including procurement and operation of container handling equipment. A private sector participation scheme will be developed to procure and operate container-handling equipment for Balikpapan port. Port sector reform will identify the action framework for policy changes in the port sector and for optimizing ferry and sea transport services and infrastructure. Capacity building and training targets improvement of port management and operation, and port security of Balikpapan and Jayapura ports. TA will prepare the Banjarmasin port development project.
- d. Expected results and deliverables:** The project will (i) deliver a new container terminal at Balikpapan and an expanded multipurpose terminal at Jayapura; (ii) create better port operation and management; (iii) support private sector investment in port operation; and (iv) result in improved, sustainable, and efficient operation of Balikpapan and Jayapura ports.
- e. Social or environmental issues or concerns: Environment.** Classified under environmental category A under ADB's Environmental Assessment Guidelines (2003), the project encompasses major construction of port facilities, and other supporting facilities and equipment. The Government will conduct environmental impact assessments for both ports. **Land acquisition and resettlement.** Land for Balikpapan port was acquired in 1997; therefore land acquisition and resettlement are not required. The expansion of Jayapura port does not require land acquisition or resettlement.
- f. Plans for disseminating results/deliverables:** To be decided.

7. Proposed executing/implementing agency or agencies: Ministry of Transportation

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: The ADB TA to prepare the Interisland Transport Project produced an interisland transport master plan for eastern Indonesia and prioritizes projects for investment based on agreed criteria. Regional and national workshops were organized to discuss the TA findings and agree on prioritized projects. The TA also produced an economic and financial assessment of the prioritized projects and confirmed their feasibility to be funded by ADB assistance. PELINDO IV, a port state-owned enterprise, which under the current law will become the port operator, has included this investment plan in its corporate plan. The minister of state-owned enterprises, to whom PELINDO IV is financially accountable, has principally agreed on the proposed project to be funded under the Government equity-sharing scheme.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP update, RCSP, RCSP update, or interregional work plan: 2004
- b. Expected date of submission for approval
 - Lending: October 2005
 - Nonlending (project preparatory):
 - Nonlending (other than project preparatory):

- c. Period and duration of assistance
 Lending: 2007–2011
 Nonlending: 2003–2005

10. Financing Plan

- a. For lending
 Ordinary capital resources: \$47 million
 Asian Development Fund:
 Other:

Source	Amount (\$ million)
ADB financing	47,000,000
Government financing	21,500,000
Other financing	-
Total Cost	68,500,000

Source: ADB estimates.

- b. For nonlending
 No resources required, other than ADB staff
 ADB's administrative budget: \$
 Grant TA funds
 Other:

Source	Amount (\$)
ADB financing	1,000,000
Government financing	250,000
Other financing	
Total Cost	1,250,000

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.6: Integrated Citarum Water Resources Management Project
Concept Paper**

Date: February 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input checked="" type="checkbox"/> Other: MFF Pilot</p> <p><input type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the</p> <p> Sectors: Agriculture and natural resources</p> <p> Subsector: Water resource management</p> <p>b. For project preparatory and lending, classification</p> <p> <input type="checkbox"/> Core poverty intervention</p> <p> <input type="checkbox"/> Poverty intervention</p> <p>c. Key thematic area(s)</p> <p> <input checked="" type="checkbox"/> Sustainable Economic Growth</p> <p> <input type="checkbox"/> Gender and development</p> <p> <input checked="" type="checkbox"/> Governance</p> <p> <input checked="" type="checkbox"/> Private sector development</p> <p> <input type="checkbox"/> Inclusive Social Development</p> <p> <input checked="" type="checkbox"/> Environmental Sustainability</p> <p> <input type="checkbox"/> Regional cooperation</p>
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>
<p>4. Responsible division/department: Agriculture, Environment & Natural Resources Division, Southeast Asia Regional Department</p>
<p>5. Responsible ADB officer: C. I. Morris</p>
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy:</p> <p>The Citarum is the most strategic river basin in Indonesia, measuring over 11,000 km² the basin is home to some 9 million people, some 390,000 ha of irrigated rice, three major dams of installed capacity 1,400 megawatts, and major industrial centers around the fourth biggest city, Bandung, and satellite industrial parks to the west of Jakarta. The Citarum river supplies some 80% of Jakarta's raw water. Poverty in the basin is significantly above national averages, with 8 of 11 districts recording poverty levels of 25% or above in 2000. Inadequate institutional arrangements, deteriorating infrastructure, competing water demands from agriculture, and rapid urban and industrial growth have led to severe water supply shortages and unhealthy environmental conditions throughout the basin.</p> <p>Water resource development has been a major area of ADB's assistance to Indonesia, totaling over \$1.5 billion in loans and TA. Promoting sustainable use of water resources in line with the ADB Water for All policy is a key element of ADB's operational partnership with Indonesia. During the 2003 country programming mission of ADB, the Government requested TA to prepare an integrated water resource management project for the Citarum basin.</p>

<p>b. Goal and purpose: The long-term goals are sustainable management of water resources for economic and social development. The immediate objective is to improve water availability and improve integrated water resource management.</p> <p>c. Components and outputs: The major components of the project will include (i) planning and program management; (ii) support to river basin management organizations (water council, regulator, and operators) and capacity building of sector agencies and local governments; (iii) promotion of community and civil society participation; (iv) water provision (system services improvements, water source development, catchment improvements, and environmental improvements); and (v) water services (irrigation modernization, hydropower, water supply, and sanitation); (vi) disaster management; and (vii) development of effective public-private partnerships.</p> <p>d. Expected results and deliverables: Improved water management and enhanced governance, more available raw water, better health and living conditions, reduced soil erosion, more rice production, hydropower, reduced damage from floods and landslips, and improved disaster management.</p> <p>e. Social or environmental issues or concerns: General improvements in social and environmental conditions. Some project interventions will require close ADB safeguard reviews.</p> <p>f. Plans for disseminating results/deliverables: Tripartite discussions, comprehensive basin-wide stakeholder participation to be designed into IWRM governance activities</p>
<p>7. Proposed executing/implementing agencies: Directorate General of Water Resources (DGWR), Ministry of Public Works, and local governments as implementing agencies</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: Engage EAs and nongovernment stakeholders in project preparation surveys, discussions, and workshops.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP update, SCSP, or interregional work plan: 2004</p> <p>b. Expected date of submission for approval Lending: 2006 Nonlending (project preparatory): 2006 (supplementary) Nonlending (other than project preparatory): 2007</p> <p>c. Period and duration of assistances Lending: - Nonlending: 2007 through 2022 (15-year program)</p>
<p>10. Financing Plan</p> <p>a. For lending <input checked="" type="checkbox"/> Ordinary capital resources: MFF (15 years): \$500 million; first tranche: \$100 million <input type="checkbox"/> Asian Development Fund: <input type="checkbox"/> Other:</p> <p>If cofinancing is required indicate sources, and amount sought: \$50 million grant funds during the MFF; possible cofinancing sources: the Netherlands and GEF. If known, provide cost estimates and financing arrangements. (e.g., total cost, ADB financing, other financing, and government financing):</p> <p>b. For nonlending <input type="checkbox"/> No resources required, other than ADB staff <input type="checkbox"/> ADB's administrative budget: <input checked="" type="checkbox"/> Grant TA funds \$1,000,000 <input checked="" type="checkbox"/> Other:</p> <p>If known, provide cost estimates and financing arrangements. (e.g., total cost, ADB financing, other financing, and government financing):</p>

ADB = Asian Development Bank, CSP = country strategy and program, SCSP = subregional cooperation strategy and program, TA = technical assistance.

**Table A7.7: Senior Secondary Education Development Project
Concept Paper**

Date: August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input checked="" type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input checked="" type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input checked="" type="checkbox"/> Other: Post-basic Education Sector Analysis and Policy Development</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Education Subsector(s): Senior secondary general education</p> <p>b. Targeting classification {check one}</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input checked="" type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme(s): Human development, developing rural areas</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Social Sectors Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: Wendy Duncan</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The labor force is not internationally competitive in all fields. More large firms report that worker education and skills levels are severe obstacles to their operation and growth than in the Philippines or India (26% cf. 18% and 13%, respectively). The industrial structure continues to be concentrated in low technology and assembly-type industries. The ADB education strategy for the CSP 2005-2009 has as one of its goals the increased competitiveness of school and university graduates, which will help improve the investment climate and contribute to economic growth by improving the skill quality of the labor force.</p>								

- b. Goal and purpose:** The project goal is a globally competitive labor force. The labor force has fewer educated employees and lower labor productivity than other countries. One reason is the lack of high-standard education. Recent Government policy emphasizes SSE system improvements to produce high-quality graduates from both general secondary (SMA) and vocational secondary (SMK) schools. A key element of this process is the National Education Law's requirement that each district have a school performing to international standards. The purpose of the project is to increase the number of SSE students graduating with improved qualifications, skills, and attributes of greater relevance to the global market place. In some cases, this will entail international accreditation and linkages, to ensure that qualifications are internationally acceptable.
- c. Components and outputs:** The project will focus primarily on improving the teaching-learning process and on school management consistent with MONE's mandate to establish international-standard schools. The project seeks to (i) improve learning outcomes of senior secondary graduates; (ii) improve senior secondary management and continuous quality assurance; (iii) increase equity for qualified students; and (iv) establish the foundation for enhanced policy and planning. The project features interventions that will establish and help to institutionalize high-performance educational standards designed to improve the quality of senior secondary education. Interventions are targeted primarily at schools, although some aspects of district, provincial, and national government operations will also benefit.
- d. Rationale and purpose of ADF grant financing :** ADF funding will be used to promote the quality of senior secondary schools, especially vocational schools that serve poor students, and to promote access on merit to international-standard schools through the use of scholarships and other support.
- e. Expected results and deliverables:** Improved learning outcomes for graduates, improved school management and quality assurance, increased equity and provision of special services, and an enhanced foundation for policy and strategy established
- f. Social or environmental issues or concerns:** None
- g. Plans for disseminating results/deliverables:** National workshops will be held regularly to discuss project progress and outputs. Positive results will be disseminated throughout project districts and provinces to highlight good practices. A workshop will be held on the results of the sector policy and analysis.

For TA, method(s) of TA output dissemination:

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify) Sector and policy analysis report published

7. Proposed executing/implementing agency or agencies: Ministry of National Education (MONE)

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

The TA team conducted extensive field work in the 160 schools selected to be the first international-standard schools. The principals of these schools and teachers of these schools, with the involvement of school committees, developed a madrasah development plan. Thorough teamwork also prevailed in MONE during the entire design phase, with MONE leading in setting the basic parameters as well as working on all detailed of implementation.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2003
- b. Expected date of submission for approval
- Lending: 2007
- Nonlending (project preparatory):
- Nonlending (other than project preparatory): 2007
- Period and duration of assistance
- Lending: Jan 2008-Dec 2013
- Nonlending: Jan 2008-Dec 2013

10. Financing Plan TBD

a. For lending

- Ordinary Capital Resources: \$50 million
 Asian Development Fund: \$50 million
 Other:

Source	Amount (\$ million)
ADB Financing	100
Government Financing	43
Other Financing	143
Total Cost	286

Source: Asian Development Bank estimates.

b. For nonlending

- No resources required, other than ADB staff
 ADB's administrative budget:
 Grant TA funds: \$1 million
 Other:

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.8: Improving Efficiency of Energy Distribution and End Use
Concept Paper**

Date: 17 March 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input checked="" type="checkbox"/> Other: MFF (Multi-tranche Financing Facility) will be explored during project processing</p> <p><input type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the</p> <p> Sector: Energy</p> <p> Subsector: Transmission and Distribution</p> <p>b. Targeting classification</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic areas</p> <p> Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input checked="" type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p> Subtheme: Promoting economic efficiency and enabling markets; cleaner production</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input checked="" type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input checked="" type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Infrastructure Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: Sohail Hasnie</p>								
<p>6. Description of assistance</p> <p>a) Background/Linkage to CSP: Recent high oil prices have made inefficient use of energy more expensive, and as a result, developing countries have a strong incentive to make energy efficiency a part of mainstream energy planning, as it has long been in the developed countries. Saving one unit of energy through efficient production or delivery with lower losses is equivalent to producing an extra unit of energy. Additional benefits are improved system capacity to supply additional customers, as well as environmental and social, as fossil energy saved means less greenhouse gases emitted.</p> <p> Energy efficiency has become a key theme for the Indonesian power sector because of high cost of energy</p>								

subsidy to national budget, low tariff compared to marginal cost of power generation, and looming supply shortage in the Java–Bali system. Power quality, particularly power supply that complies with voltage and internationally comparable standards of reliability, is also a key theme to be considered in conjunction with specific energy efficiency.

These themes are also consistent with ADB's energy policy 2000 that supports "design and implementation of measures to improve the efficiency of energy supply and use". This project will be part of the new CSP.

- b. Impact and outcomes:** The expected impact of the project is to mainstream energy efficiency as a strategic planning option to reduce the overall cost of operating the distribution business for PLN and its customers; and deliver good-quality (less voltage fluctuation and improved harmonics) and reliable (less frequent and shorter interruptions) electricity. The main outcomes are efficient distribution of electricity (with less distribution losses) and better end-user efficiency (promotion of efficient equipment at consumer end through targeted incentives).

Energy efficiency activities could also qualify for clean development mechanism (CDM) credit agreed under the Kyoto Protocol, which enabled companies and governments in developed countries to purchase emission reduction credits from energy-saving projects in developing countries, either to offset the credits against their compliance targets, or to trade them on the open market. In particular, reduced losses in PLN's distribution represent a considerable reduction in the carbon dioxide (CO₂) emissions that would have resulted from generation of the additional energy. The measured emission savings, verified under agreed protocol, would be converted into carbon credits, and these credits could be sold for improving the overall financial rate of return of energy-efficiency projects.

- c. Components and outputs:** The project will have four components: (i) power factor improvement; (ii) distribution system reconfiguration; (iii) reliability improvement; and (iv) demand side management. Overall, the components of the project will allow PLN to meet the growing power needs without building new power stations and new distribution capacity; this would be possible as the project components will allow PLN to meet the lower demand (reduced as a result of DSM initiatives) by delivering electricity from existing generation over existing distribution network more efficiently.

The project will cover the whole PLN distribution system in the Java-Bali grid that comprises five regions: Greater Jakarta and Tangerang (Jakarta), West Java and Banten (Bandung), Central Java and Yogyakarta (Semarang), East Java (Surabaya) and Bali (Denpasar).

Component A: Power factor improvement

PLN regional distribution network in the Java–Bali grid have large number of distribution feeders that are 40 km or longer, especially outside Jakarta where supply areas are predominantly rural and semi-rural. Power factor correction in these areas will not only return benefits from reduced losses but also yield spare system capacity.

A large number of pole-mounted capacitor banks will be used to improve the power factor.

Component B: Distribution system reconfiguration

Over the years, PLN has deferred investment in the distribution network as it lacked the necessary funds, although both electricity demand and customer numbers have grown, overloading the network and reducing power quality. This also accelerated degradation of certain distribution assets, particularly underground distribution in Bandung and Jakarta. This project component will support system reconfiguration and reinforcement to reverse the degradation process.

Voltage regulators, filters, and other equipment will be installed under this component.

Component C: Reliability improvement

This will cover industrial and commercial areas with load of high economic value, where the cost of low reliability is exceptionally high. Sub-projects will be ranked in terms of the avoidance of "the cost of reliability" to PLN's customers. Based on measurements and reviews of distribution system performance in high value load areas, analysis will rank the feeders in terms of power quality and reliability, based on system average interruption-duration index (SAIDI), and system average interruption frequency index (SAIFI). Solutions will be designed to upgrade the worst-performing feeders (first) down the list until the economic cost–benefit cut-off is reached.

Control system upgrade including supervisory control and data acquisition (SCADA), telecommunications systems, relay, switch and protection equipment will be installed under this component.

Component D: Demand side management (DSM)

The DSM program will cover planning, implementation, and monitoring to encourage consumers to modify their level (demand clipping) and pattern (demand shifting) of electricity usage. DSM programs will be designed to develop cost-effective energy and capacity resources by deferring the need for new capacity of power generation (or power purchases), transmission, and distribution. This will cover the commercial, industrial, government buildings and residential sectors, and will include energy-efficient equipment, system upgrades, demand response, and combined heat and power projects.

Since the main customer class controlling the peak load is residential lighting (60–70%), except in Jakarta, which is driven by the commercial load, the most effective immediate DSM options would be efficient lighting programs. These may include the following:

- High-Efficiency Compact Fluorescent Lamp Lighting Program, to replace the less efficient incandescent lamp with high-efficiency lights in the residential and commercial sectors;
- High-Efficiency Linear Fluorescent Lighting Program, to promote the use of high-efficiency linear fluorescent lamps with high-frequency low-loss electronic ballasts in the residential and business sectors;
- High-Efficiency Streetlight Lighting Program, to encourage the use of high-pressure sodium lamps instead of mercury vapor lamps.

d. Rationale and purpose of ADF grant financing:

Not applicable

e. Expected results and deliverables:

Lower distribution losses, improved reliability and power quality, deferral of distribution capacity additions, and avoided generation cost

f. Social or environmental issues or concerns:

As all equipment will be installed inside existing substations, and since the power factor correction units will be mounted on existing distribution poles, no adverse social and environmental issues are expected in the project.

g. Plans for disseminating results/deliverables:

For TA, method(s) of TA output dissemination:

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify) _____

7. Proposed executing/implementing agency or agencies: State Electricity Company (Perusahaan Listrik Negara [PLN])

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: BAPPENAS, PLN regional and technical staff

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006
- b. Expected date of submission for approval
 Lending: Q2, 2007
 Nonlending (project preparatory): 2007
 Nonlending (other than project preparatory):
- c. Period and duration of assistance(s)
 Lending: 36 months, 2007-2010
 Nonlending:

10. Financing Plan

- a. For lending
- Ordinary capital resources: \$250 million
 - Asian Development Fund (loan): \$
 - Asian Development Fund (grant): \$
 - Other: \$

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

Source	Amount (\$ million)
ADB Financing	250
Government Financing	110
Other Financing	
Total Cost	360

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, PLN = Perusahaan Listrik Negara, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.9: Financial Governance and Social Security Reform Program (FGSSR)
II and III
Concept Paper**

Date: 3 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input checked="" type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other</p> <p><input type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Finance Subsectors: Banking systems; pensions, insurance, social security, and contractual savings</p> <p>b. Targeting classification</p> <p><input checked="" type="checkbox"/> Targeted intervention</p> <p><input type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p>Subthemes: Promoting economic efficiency and enabling markets, financial and economic governance.</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Governance, Finance and Trade Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: V. Subramanian</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The banking sector still dominates the financial system, with almost 80% of total assets. The small nonbank financial sector is poised to grow. The Government is actively supporting growth of nonbank financial institutions (NBFIs) to improve mobilization and financial intermediation and reduce dependence on the banking sector as the main provider of financial resources. The stock market is small in terms of capitalization to GDP, at about 30% compared with around 70% in Thailand and 150% in Malaysia. Outstanding government bonds amounted to 19% of GDP at the end of 2005. Trading in</p>								

bond markets has been thin partly because of the lack of benchmarks for pricing and poor price discovery and transparency. New regulations were introduced in 2004 for the mutual fund industry but need to be enhanced to meet international standards on mutual fund regulation. The insurance industry is small in terms of premiums to GDP, at barely 2%, and total assets equivalent to 3% of GDP. The industry is not healthy financially, with five insolvent non-life companies and six insolvent life companies still operating. The pension fund industry is also small, with assets equivalent to 4.5% of GDP. The new law on social security of 2004 paves the way for reform of pension funds but its implementation is slow. Since the financial crisis in 1997, a lot of effort has been put in to strengthening regulation and supervision of financial institutions. The Capital Market Law, Insurance Law, and Pension Fund Law are all being amended, and further improvements are needed for it to meet international standards. The overall goal is to set up a consolidated regulator for the financial sector, the OJK. The starting date was initially 2003 but has been postponed until 2010.

Microenterprises and SMEs are highly informal and are neither growing nor generating jobs. Official interventions to support them must, therefore, take a long-term view that focuses on creating conditions for them to move toward greater formality, with a stronger legal basis supporting their increased access to finance.

ADB's ongoing work in the financial sector stems from the financial crisis. The immediate support following the crisis was part of the multi-donor package to help restructure the banking sector and improve financial and public sector allocation of resources. After the multi-donor initial package of support, ADB moved toward supporting development of the nonbank financial sector (NBFS), and ceased its involvement in the banking sector.

Strengthening and development of the financial sector is a priority for the Government, and in July 2006 the Government announced a financial sector policy package aiming to (i) ensure financial system stability, (ii) strengthen banking institutions, (iii) strengthen nonbank institutions, (iv) promote capital market development, (v) improve financing for microenterprises and SMEs, (vi) improve financing for infrastructure, (vii) address tax distortions across financial instruments, and (viii) improve financing for exports and start privatizing SOEs.

b. Goal and purpose: The proposed program loan will be a cluster of two programs, in 2007 and 2009, and will help the Government develop and implement a medium-term vision and goal for 2007–2011 to develop the NBFS, including social security.

c. Components and outputs: The cluster programs would follow FGSSR I, approved in 2002, as well as the reforms subsequently initiated in financial sector regulation and supervision, governance, accounting, and anti-money-laundering policies, and development of a national social security system. FGSSR II and III will be guided by the Government's financial sector policy package and facilitate sequenced implementation in core sectors other than banking. The recommendations on policy reforms under TA 3850 Establishment of a Financial Services Authority, which covers pensions, insurance, securities risk management, mutual funds regulation, enforcement, training, and capital market legal and regulatory reforms, should provide the basis for the GGSSR II and III program components. Bond market development would be another major area of thrust under the programs; development of the long-term market for debt securities is critical to facilitate financing of infrastructure projects. In addition, informal requests have also been made to support development of regulation for Islamic financial services.

The social security component will include strengthening the institutions related to pensions under MOF (Bapepam and Taspen) by preparing rules and regulations, strengthening institutions, and building capacity, and helping prepare a pension program. In case the National Social Security System Law is implemented, the FGSSR II and III will help prepare a multi-pillar pension program, besides strengthening governance and financial management in the pension industry.

Assistance to the microfinance industry will focus on creating conditions for small, largely informal operations to move toward greater formality, with a stronger policy, legal, and regulatory basis supporting their increased access to finance.

e. Expected results and deliverables: Implementation of sequenced set of policy actions and reforms over the medium term (2007-2011) leading to the development of a strong and resilient nonbank finance sector with improved governance and institutional capacity. In particular, FGSSR II and III will lead to (i) a strong independent nonbank financial sector regulator overseeing capital markets, insurance, and pensions, (ii) market development and products and services that range from fund management to insurance/leasing, (iii) strengthened enforcement and surveillance across nonbank sectors, (iv) accounting standards in line with international governance and transparency standards, (v) enhanced institutional capacity and investor awareness, (vi) developed debt market, including government bond markets/market infrastructure/ secondary trading, (vii) strengthened insurance sector through strengthened regulations regarding reserves, capital

requirements, reinsurance, and investment management in line with international best practices, (viii) pension reforms and improved governance, institutional capacity, and financial management in pension funds.

f. Social or environmental issues or concerns: Social sector issues will be addressed in the context of the reforms to the pension industry. No environmental issue or concerns are envisaged under the FGSSR II and III.
Plans for disseminating results/deliverables: This will be done through a series of workshop/seminars, financial sector forums, and related websites.

7. Proposed executing/implementing agency or agencies: Ministry of Finance (Capital Market and Financial Institution Supervisory Agency), TASPEN (Pension Savings Insurance), Bank Indonesia

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:
 Through a series of consultations with all government ministries and department involved in the relevant sectors under the proposed program

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006
- b. Expected date of submission for approval
 - Lending: November 2007 and 2009
 - Nonlending (project preparatory): not applicable
 - Nonlending (other than project preparatory): not applicable
- c. Period and duration of assistance(s)
 - Lending: 2007–2011
 - Nonlending: not applicable

10. Financing Plan

- a. For lending
 - Ordinary capital resources: \$200 million for FGSSR II and \$200 million for FGSSR III
 - Asian Development Fund (loan):
 - Asian Development Fund (grant):
 - Other:

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.10: Secondary Mortgage Facility
Concept Paper**

Date: 3 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p><input checked="" type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other</p> <p><input type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Finance Subsector(s): Housing Finance</p> <p>b. Targeting classification</p> <p><input checked="" type="checkbox"/> Targeted intervention</p> <p><input type="checkbox"/> General intervention</p> <p>c. Key thematic area</p> <p>Themes:</p> <table> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme: Promoting economic efficiency and enabling markets, financial and economic governance.</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Governance, Finance and Trade Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: V. Subramanian</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The National Poverty Reduction Strategy identifies access to adequate housing among the 10 basic rights that remain to be fulfilled. With the Government's recent thrust on fiscal consolidation, the national public sector resources serve to meet only a small fraction of the needs of the underserved households. Despite a decrease in mortgage lending immediately after the Asian financial crisis, the market experienced increase in the housing loan portfolio over the last 6 years. Outstanding housing loans totaled Rp56 trillion in 2005, compared with Rp20 trillion in 1997. However, the</p>								

percentage of housing loans to total loans continues to be low. Outstanding loans for housing and apartment ownership comprise only 8.1% of the total loan assets of the banking sector as of December 2005. Access to long-term resources has been a major impediment to banks increasing their housing loan portfolio, besides absence of standard underwriting procedures.

Outstanding government bonds amounted to 19% of GDP at the end of 2005. Bond market capitalization rose to Rp466 trillion in December 2005, of which 87% comprise government bonds. Corporate bonds issuance has remained low at around Rp50 trillion. Creation of a secondary mortgage market and issuance of mortgage backed securities has been used in other developed markets to meet the long-term funding requirements of the housing finance industry. Housing finance constitute 30-40% of GDP in developed economies.

The administration of President Susilo Bambang Yudhoyono included in its initial 100-day program actions to make housing more available. In February 2005, he issued a decree on secondary mortgage financing to facilitate long-term financing for mortgages through securitization. PT Sarana Multigriya Financial (PT SMF) was established in 2005 under the provisions of the decree as a state-owned company. The authorized capital of PT SMF was prescribed to be Rp4 trillion, against which Rp1 trillion was invested by the Government. ADB is supporting the establishment of PT SMF through TA 4715, which will help establish operational guidelines, standardize documentation, and build capacity within PT SMF on underwriting and risk management. The TA is expected to help MOF and ADB develop financial assistance to support PT SMF mandate and operations. In the initial stages, PT SMF will make available long-term loans to financial institutions, which adopt their standards for mortgage underwriting and documentation. As the pool of qualifying mortgages accumulates and becomes seasoned, PT SMF will purchase the mortgages for securitization (MBS). The company may also act as guarantor for MBS issuances. PT SMF initially will focus to build up a critical mass of primary housing receivables in the market that could eventually facilitate securitization of mortgage-backed assets.

- b. **Goal and purpose:** The Government has requested ADB assistance in supporting PT SMF operationalize the securitization market and increase the housing stock of the low- and middle-income population. ADB's multitranche financing assistance is expected to be extended over 4-5 years to enable PT SMF to become a sustainable mortgage financing institution and to develop a securitization market for housing receivables and provide the much-needed sustainable source of long-term finance for housing.
- c. **Components and outputs:** ADB assistance will be in the form of a multi-tranche financing facility to be extended over 4–5 years. Though the modality and tranching will be finalized later in agreement with the Government, it is envisaged that PT SMF will initially require long-term local currency financing from ADB of about \$50 million equivalent in 2007, supported by a sovereign guarantee to build the critical mass of primary housing receivables that will eventually qualify for securitization. This will be followed by possible guarantees as a means of credit enhancement—to be provided by ADB later in phases as required—envisaged in the range of \$150 million–\$200 million to support PT SMF bond issuance. The requirement of any Government counter-guarantee for ADB's proposed guarantee assistance will be based on the credibility and level of PT SMF operations at that point in time. It is expected that the proposed ADB assistance will strengthen the operations of PT SMF and help develop a sustainable long-term sustainable housing finance market by developing the securitization market for mortgage-backed receivables. This will also enable the development of the bond market and help further deepen the financial sector.
- e. **Expected results and deliverables:** The project aims to deepen the financial sector by improving access to long-term funds via the bond market. The project will create a sustainable source of long-term financing to mortgage lenders by creating secondary mortgage and mortgage-backed securities markets. The project is designed to facilitate the development of PT SMF into a financially viable stand-alone institution in mortgage financing and securitization. A multi-tranche finance facility \$250 million blended with ADB loan and guarantee products will be provided to meet the mortgage financing needs of low- and medium-income people during the first [5–7] years of PT SMF operations.
- f. **Social or environmental issues or concerns:** Though no social or environmental issue or concerns are envisaged under the project, any social issues will be addressed during loan processing.

Plans for disseminating results/deliverables: This will be done through a series of workshop/seminars, financial sector forums, and related websites.

- 7. Proposed executing/implementing agency or agencies: Ministry of Finance (Capital Market and Financial Institution Supervisory Agency (Bappepam), PT. Sarana Multigriya Finance), Bank Indonesia

<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: Through a series of consultations with all government ministries and department involved under the proposed program</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006</p> <p>b. Expected date of submission for approval Lending: November 2007 Nonlending (project preparatory) :NOT APPLICABLE Nonlending (other than project preparatory): Assistance proposed beyond 2007 is envisaged in the form of guarantees in 2009, 2010-2012. Proposals will be submitted in 2007, 2009, 2010</p> <p>c. Period and duration of assistance Lending: 2007-2008 Nonlending: 2009, 2010-2012</p>
<p>10. Financing Plan</p> <p>a. For lending</p> <p><input checked="" type="checkbox"/> Ordinary capital resources: \$50 million</p> <p><input type="checkbox"/> Asian Development Fund (loan): \$</p> <p><input type="checkbox"/> Asian Development Fund (grant): \$</p> <p><input checked="" type="checkbox"/> Other:- ADB guarantee products in the range of \$150 million–\$200 million spread over 4–5 years</p>

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.11: Nutrition Improvement Through Community Empowerment (NICE) Project
Concept Paper**

Date: 27 July 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p> <input checked="" type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other:</p> <p><input type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Health, nutrition, and social protection Subsector: Nutrition</p> <p>b. Targeting classification</p> <p> <input checked="" type="checkbox"/> Targeted intervention</p> <p> <input type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input checked="" type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input checked="" type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme: Human development, other vulnerable groups</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input checked="" type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input checked="" type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Social Sectors Division, Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: B. Lochmann</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: Malnutrition undermines economic growth and perpetuates poverty. It is one of the most important constraints to achieving the Millennium Development Goals (MDGs). Malnutrition remains a significant urban and rural public health problem. The prevalence of underweight children increased from 16.8% in 2000 to 19.0% in 2003,¹ which implies that the cognitive and behavioral functions of about 8 million children under 5 years of age will be threatened by malnutrition.</p>								

¹ Moderate underweight from 16.8% to 19.0% and severe underweight from 7.8% to 8.8% in 2000–2003.

Underweight in infancy and early childhood lowers school enrollment rates and stunts cognitive and behavioral development. The prevalence of iron deficiency anemia (IDA) is 63% in pregnant women, which is associated to low birth weight and responsible for 25% of maternal deaths. About 55% of preschool children suffer from IDA, which results in underweight because of the poor quality of complementary food and feeding practices. Wide disparities exist in health and nutrition outcomes, with rural–urban, geographical, and socioeconomic differentials. The disparity in the proportion of underweight children under 5 years of age between provinces is striking, ranging from 17.9% in Bali to levels as high as 42.0% in Gorontalo. This situation hinders achieving MDG 1: Eradicate extreme poverty and hunger. The Government's Medium-Term Development Plan (2004-2009) outlines the Government's 5-year strategic development policy framework. It identifies the reduction malnutrition by 20% and severe malnutrition by 5% by 2009 as a key priority in reducing poverty and vulnerability. As a response to the nutrition crisis in early 2005, MOH developed the National Action Plan on Malnutrition (2005-2009)². The project is in line with ADB's proposed CSP 2009 to accelerate achievement of the MDGs.

- b. Goal and purpose:** The goal of the project is to improve the nutrition status, especially of poor children under age 5, and pregnant and lactating women. The outcome of the project will be increased access to nutrition services and strengthened nutrition and hygiene behavior in urban and rural areas. The project will improve provincial and district governments' capacity to plan, manage, and monitor nutrition services and programs; mobilize communities to participate in such interventions based on a demand-driven community-based approach; and increase knowledge and awareness about appropriate nutrition and hygiene behavior.
- c. Components and outputs:** The project is designed to deliver four outputs: (i) a more effective institutional environment for nutrition policy development, planning, and management of nutrition programs; (ii) increased access by at-risk groups to nutrition services through community mobilization; (iii) improved regulation for food fortification; and (iv) more knowledge sharing in relation to malnutrition and its prevention as well as the benefits of food fortification. In line with these outputs, the scope of the project is divided into the following components (i) institutional development for nutrition policy, programs, and surveillance; (ii) community-based nutrition services; (iii) food fortification; and (iv) nutrition education and communication.
- d. Rationale and purpose of ADF grant financing:** The project will focus on nutritionally at-risk populations, vulnerable children, and women in low-income areas.
- e. Expected results and deliverables:** The project will result in (i) strengthened capacities; (ii) improved operational efficiency of nutrition services, especially for poor women and children; (iii) efficient delivery of mandated fortified food through improved quality assurance of fortified food; and (iv) improved knowledge and behavior related to the prevention of malnutrition by government, the private sector, and communities.
- f. Social or environmental issues or concerns:** None
- g. Plans for disseminating results/deliverables:**
For TA, method(s) of TA output dissemination:
- A conference/workshop/brown bag
 - Publication of article(s) in external journals or books
 - External press release to news agencies, including www.adb.org
 - Internal press release in *ADB Today*
 - Others (specify) website of MOH

7. Proposed executing/implementing agency or agencies: Ministry of Health

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

The project will focus on community-based services and involve community-based organizations and nongovernment organizations.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006
- b. Expected date of submission for approval

² National Action Plan on the Prevention of Severe Malnutrition. Ministry of Health, 2005.

Lending: 2007
 Nonlending (project preparatory):
 Nonlending (other than project preparatory):

c. Period and duration of assistance
 Lending: 2007-2013
 Nonlending:

10. Financing Plan

a. For lending

- Ordinary capital resources:
- Asian Development Fund (loan): \$50 million
- Asian Development Fund (grant):
- Other: JSF/TASF \$1.5 million

If cofinancing is required, indicate amount and sources sought: \$, from _____

Source	Amount (\$ million)
ADB Financing	50.00
Government Financing	21.40
Other Financing	
Total Cost	71.40

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A7.12: Poverty Reduction and MDG Acceleration Program
Concept Paper**

Date: 4 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input checked="" type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input checked="" type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input checked="" type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sectors: Multisector, including education; health, nutrition, and social protection; law, economic management, and public policy Subsectors: Basic education, health systems, public finance and expenditure management</p> <p>b. Targeting classification</p> <p><input checked="" type="checkbox"/> Targeted intervention</p> <p><input type="checkbox"/> General intervention</p> <p>c. Key thematic areas</p> <p>Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input checked="" type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subthemes: Human development, public governance, financial and economic governance, and institutional development</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input checked="" type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Southeast Asia Social Sectors Division/Southeast Asia Department</p>								
<p>5. Responsible ADB officer: A. Perdiguero</p>								
<p>6. Description of assistances</p> <p>a. Background/linkage to country/regional strategy: At the Millennium Summit in September 2000, the Government committed to a new global partnership to reduce poverty, improve health and education, and promote gender equality and environmental sustainability. As a signatory of the Millennium Declaration, Indonesia committed itself to achieve its national MDGs by 2015. General progress at national level in achieving most (but not all) of the MDGs obscures vast differences across regions and districts, rural and urban areas, income groups, and gender. While Indonesia has achieved high levels of access to primary</p>								

education for children age 7 to 12, children in rural areas are as much as 20% less likely to enroll and stay in school than their urban peers. Many children never make the transition from primary to junior secondary education. Some of the health-related targets are particularly off-track, with an estimated 582,000 new cases of tuberculosis every year and persistent high levels of maternal mortality rates. Indonesia has made significant progress in reducing income poverty over the past decades, despite the setback of the Asian financial crisis. Income poverty headcounts measured with the national poverty line have been falling steadily since 1999. In 2004, the poverty incidence was once again below pre-crisis levels, at 16.7% of the population, which still translates to over 36 million people. Many more remain vulnerable to poverty.

A lack of access to key social services such as health and education is one of the main causes of poverty in Indonesia. Lack of access to basic education significantly decreases productivity and personal income, thereby keeping households poor. Poor households also feel the direct impact of deficient health care services and degradation of their health status not only through the deterioration in their direct quality of life (improved health and life expectancy) but also in reduced earnings and income instability caused by increases in prolonged spells of illness. Development expenditures have declined from around 8% of GDP in the early 1990s to just over 2% in 2004, in large part because of fiscal prudence, decentralization, and the increased burden of fuel oil subsidies. Declining development expenditure has contributed to variation in attaining MDGs across provinces and districts. Higher levels of more efficient and effectively targeted public investment in key social sectors are needed to accelerate MDG achievement. Decentralization has made this even more urgent.

b. Goal and purpose: The PRMAP impacts will be to accelerate progress toward achieving the MDGs in education (MDG 2), health (MDGs 4, 5, 6) and poverty reduction (MDG 1), and gender equality (MDG 3), and toward reducing regional social disparities. The program's outcome is the reorienting, scaling up, and enhancing of Government's social expenditure programs by improving the access, equity, quality, governance, and monitoring of education and health service delivery.

c. Components and outputs: The proposed sector development program will have two main components:

i. Component I—policy-based lending aimed at up-front sector reforms to increase effectiveness of social service delivery, specifically in sectors and expenditure programs supported by components II and III. The program will support targeted sector policy actions and reforms to improve quality of and access to education, health and nutrition, and water supply and sanitation. Sector reforms will be fully consistent with the priorities in Medium-Term Development Plan (RPJM) and national action plans. Resource allocation will be scaled up by the Government by setting aside part of local currency proceeds from the program loan for an earmarked basis to local governments. The program will support appropriate intergovernmental transfer mechanisms, including use of block grants and/or expanded Special Funding Allocation/DAK to work with and through local governments in delivering public services.

ii. Component II - Grant technical assistance The mid-term development outputs of this TA in 15 selected districts include (i) expanded access to health and education services by prioritizing and reorienting public expenditure towards MDG acceleration; (ii) improved quality, efficiency, and effectiveness of service delivery in health and education; (iii) enhanced governance in delivery of health and education; and (iv) improved monitoring and evaluation systems in health and education sectors. Longer-term outputs include the strengthened management of decentralized health and education sectors.

Outputs to include:

i. Prioritized and reoriented public expenditure towards MDG acceleration. Increased size, coverage, and targeting in education and health, developed medium-term performance-based budgeting and expenditure framework for the health and education sectors.

ii. Improved quality, efficiency and effectiveness of social service delivery. To be improved through sector-level policy and institutional reforms, and by working with local and central government to identify and address operational weaknesses in service delivery and to better align local incentives with national MDG priorities.

iii. Enhanced governance in social service delivery. To be enhanced through support for stronger fiduciary management and controls, including audit mechanisms, and increased transparency and accountability, including support for public disclosure and feedback systems.

iv. Effective monitoring and evaluation systems. PRMAP will support monitoring and evaluation systems to help district (and maybe provincial and national) governments, and beneficiaries/consumers track the allocation and use of public expenditures, the supply and quality of social service delivery, and their outcomes under Government programs supported by PRMAP, particularly to monitor progress toward MDG targets.

<p>d. Expected results and deliverables. Improved access to and quality of basic social services supported under PRMAP, which will have a positive impact on the relevant MDG indicators.</p> <p>e. Social or environmental issues or concerns: None</p> <p>f. Plans for disseminating results/deliverables: To be determined in line with the program objective of enhancing fiduciary management, transparency and accountability in public service delivery.</p>
<p>7. Proposed executing/implementing agency or agencies: BAPPENAS (National Development Planning Agency)</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:</p> <p>Preliminary consultations have been conducted with BAPPENAS, the Coordinating Ministry for Peoples Welfare, and the ministries of finance, education, health, and religious affairs. Program design builds on Government's request for support in accelerating the achievement of MDGs. The proposed approach to build on and enhance existing Government spending programs ensures alignment with Government priorities.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006</p> <p>b. Expected date of submission for approval Lending: 2007 (Subprogram 1) Nonlending (other than project preparatory): 2007</p> <p>c. Period and duration of assistance Lending: 2007-2008 Nonlending: 2007-2008</p>
<p>10. Financing Plan</p> <p>a. For lending</p> <p><input checked="" type="checkbox"/> Ordinary capital resources: \$ 200 million</p> <p><input type="checkbox"/> Asian Development Fund (loan):</p> <p><input type="checkbox"/> Asian Development Fund (grant):</p> <p><input type="checkbox"/> Other:</p> <p>b. For nonlending</p> <p><input type="checkbox"/> No resources required, other than ADB staff</p> <p><input type="checkbox"/> ADB's administrative budget:</p> <p><input checked="" type="checkbox"/> Grant TA funds: \$ 2 million</p> <p><input type="checkbox"/> Other:</p> <p>If cofinancing is required, indicate amount and sources sought: Yes it is sought (amount TBD)</p>

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

CONCEPT PAPERS FOR NONLENDING PRODUCTS

This appendix contains the concept papers for the following non lending products:

- (i) Table A8.1: Capacity Building for Water Resources Management under Decentralization Framework
- (ii) Table A8.2: Urban Air Quality Improvement (Supplementary)
- (iii) Table A8.3: Legal and Administrative Framework for Land Acquisition and Resettlement
- (iv) Table A8.4: Strengthening Capacity to Improve Aid Effectiveness
- (v) Table A8.5: Regional Road
- (vi) Table A8.6: Flood Management in Selected River Basin in Java (Supplementary)
- (vii) Table A8.7: HIV in the Transport Sector
- (viii) Table A8.8: Second Neighborhood Upgrading and Shelter Sector Project (NUSSP II)
- (ix) Table A8.9: Investment Climate, Finance, and Poverty Reform Cluster
- (x) Table A8.10: Physical Infrastructure Development Cluster
- (xi) Table A8.11: Support for Developing Disaster Risk Management
- (xii) Table A8.12: Support for Results Management in National Planning

**Table A8.1: Capacity Building for Water Resources Management
under Decentralization Framework
Concept Paper**

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p> <input type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input checked="" type="checkbox"/> Other than project preparatory</p> <p> <input checked="" type="checkbox"/> Economic, thematic, and sector work</p> <p> <input checked="" type="checkbox"/> Institutional development</p> <p> <input checked="" type="checkbox"/> Other: Environment</p>										
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Agriculture, Natural Resources, and Environment Subsector: Water Resources Management</p> <p>b. For project preparatory and lending, classification</p> <p> <input type="checkbox"/> Core poverty intervention</p> <p> <input type="checkbox"/> Poverty intervention</p> <p>c. Key thematic area(s)</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Economic growth</td> <td><input type="checkbox"/> Human development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Good governance</td> </tr> <tr> <td><input checked="" type="checkbox"/> Environmental protection</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Regional cooperation</td> <td><input type="checkbox"/> Social protection</td> </tr> <tr> <td><input type="checkbox"/> Other:</td> <td></td> </tr> </table>	<input checked="" type="checkbox"/> Economic growth	<input type="checkbox"/> Human development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance	<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection	<input type="checkbox"/> Other:	
<input checked="" type="checkbox"/> Economic growth	<input type="checkbox"/> Human development									
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance									
<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development									
<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection									
<input type="checkbox"/> Other:										
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional <input type="checkbox"/> Internal policy development</p>										
<p>4. Responsible division/department: Agriculture, Natural Resources and Environment Division, Southeast Asia Regional Department</p>										
<p>5. Responsible ADB officer: C. Morris</p>										
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy</p> <p>The ongoing administrative and fiscal reforms (under the Regional Autonomy and Fiscal Autonomy Acts of 22 and 25, respectively, of 1999) and the water sector reforms are mutually reinforcing, both in concept and timing, and provide an excellent opportunity for changing the approach to management of water resources. However, successful implementation of the sector reforms will require strengthening of regional institutions. Sustainable management of natural resources, including water resources, is a priority item in ADB's operational strategy, and ADB support for the proposed TA will help implement the strategy.</p> <p>b. Goal and purpose</p> <p>The long-term goal is sustainable management of water resources for economic and social development. The immediate objective is to develop institutional and technical capacity of regional governments for effective planning, development, and management water resources for multisectoral uses.</p> <p>c. Components and outputs</p> <p>The TA will provide for a comprehensive assessment of regional institutional arrangements for water resources management vis-à-vis functions and responsibilities being devolved to regions by the central Government, and identification and recommendation of specific measures for developing efficient,</p>										

<p>accountable, and transparent sector agencies.</p> <p>d. Expected results and deliverables TBD</p> <p>e. Social or environmental issues or concerns (if any) No major social or environmental issues anticipated.</p> <p>f. Plans for disseminating results/deliverables To be developed during the study.</p>
<p>7. Proposed executing/implementing agencies: Directorate General of Regional Development, Ministry of Home Affairs</p>
<p>8. Nature/extent of government/beneficiary involvement in identification or conceptualizing the assistance</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP update, SCSP, SCSP update, or interregional work plan - 2003</p> <p>b. Expected date of submission for approval</p> <p>Lending Nonlending (project preparatory) - 2006 Nonlending (other than project preparatory)</p> <p>c. Period and duration of assistance (s)</p> <p>Lending Nonlending – 2006–2007</p> <p>CSP = country strategy and program, SCSP = subregional cooperation strategy and program.</p>
<p>10. Financing Plan</p> <p>If cofinancing is required indicate sources, and amount sought: If known, provide cost estimates and financing arrangements.</p> <p>a. For nonlending</p> <p><input type="checkbox"/> No resources required, other than ADB staff</p> <p><input type="checkbox"/> ADB's administrative budget:</p> <p><input checked="" type="checkbox"/> Grant TA funds: \$1 million</p>

**Table A8.2: Urban Air Quality Improvement (Supplementary)
Concept Paper**

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input checked="" type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>												
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Agriculture and natural resources Subsector: Environment and biodiversity</p> <p>b. For project preparatory and lending, classification</p> <p><input type="checkbox"/> Core poverty intervention</p> <p><input type="checkbox"/> Poverty intervention</p> <p>c. Key thematic areas:</p> <table border="0"> <tr> <td><input type="checkbox"/> Economic growth</td> <td><input type="checkbox"/> Human development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Good governance</td> </tr> <tr> <td><input checked="" type="checkbox"/> Environmental protection</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Regional cooperation</td> <td><input type="checkbox"/> Social protection</td> </tr> <tr> <td><input type="checkbox"/> Other:</td> <td></td> </tr> </table>			<input type="checkbox"/> Economic growth	<input type="checkbox"/> Human development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance	<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection	<input type="checkbox"/> Other:	
<input type="checkbox"/> Economic growth	<input type="checkbox"/> Human development											
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance											
<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development											
<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection											
<input type="checkbox"/> Other:												
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p>												
<p>4. Responsible division/department: Infrastructure Division, Southeast Asia Department</p>												
<p>5. Responsible ADB officer: Yue-Lang Feng</p>												
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy:</p> <p>Rapid urbanization and lack of appropriate enforcement mechanisms and strategies have made air pollution a significant health threat to urban residents, and more so for the poor. Improvement of urban air quality is a principal area of ADB's environmental management program. It requires strengthening governance, clarifying the policy and regulatory frameworks, and enforcing laws. Capacity building of sectoral agencies and local governments for environmental protection is also an important element.</p> <p>The Government promulgated the Air Pollution Control Act in 1999, and issued a number of programs, decrees or standards associated with air quality management, to control emissions from vehicles and stationary sources. The Government launched the Blue Sky Program in 1996, which includes activities for both stationary and mobile sources. For stationary sources, the earlier phase of the program focused on cement factories, iron and steel, pulp and paper, and coal-fired power generation, and targets five of the largest cities: Jakarta, Bandung, Surabaya, Semarang, and Medan.</p> <p>However, the Government faces challenges in enforcing the regulations and programs, and reviewing the achievement of air quality improvement, mainly because of the lack of institutional capacity, absence of a</p>												

complete environmental database and its management, and insufficient human resources. After the Regional Autonomy laws 22 and 25/1999 came into effect on 1 January 2001, the lack of implementation framework and capacity of regional governments in air quality management, which further weakens the enforcement of air quality regulations and affects the health and welfare of urban residents. The standards for ambient air quality and emission limits for stationary and mobile sources that were promulgated in mid-1990s might need to be reexamined and amended to ensure that they meet the objectives of safeguarding human health and welfare, and protecting other living creatures. The emission of pollutants is expected to increase considerably as the economy grows unless actions are taken.

b. Goal and purpose:

The proposed Program will include two components: A: Clean Vehicle Fuel for Blue Skies, and B: Urban Air Quality Improvement Sector Development Program, which will include a policy-based policy loan, a project loan, and a credit line through financial intermediary. The goal of component A is to promote the use of compressed natural gas (CNG) to reduce vehicular emissions. Its purposes are to assist PGN and private sector to develop CNG infrastructure and vehicles and to assist the Ministry of Environment to develop an action plan on vehicle emission reduction. The goal of component B is to promote policy reforms to improve air quality through the abatement of mobile and stationary sources of air pollution. The purposes of the component B are to assist the Government to develop appropriate policy and regulatory framework, improve implementation strategies and facilities, and strengthen institutional capacity and enforcement in central government and regional governments to improve air quality in an effective and sustainable way. The focus area of the program will be DKI Jakarta and its neighboring regencies (Jakarta, Bogor, Tangerang, and Bekasi, together known as JABOTABEK). JABOTABEK is tentatively selected as the program area as it is likely in one airshed given its topographic features. There are potential issues of trans-boundary movement of air pollutants resulting from the communication of workers and residents in the region that need to be addressed with a regional approach. The program area will be finalized after consultation with the Government during preparation stage.

c. Components and outputs:

Component A will include an investment component to (i) promote the use of CNG to reduce the pollution caused by vehicular emissions and thereby help improve urban air quality, and (ii) strengthen the air emission testing and monitoring framework. It will also include TA to help the Ministry of Environment develop an action plan on reducing vehicle emissions.

The subcomponents and outputs of component B are as follows. The policy loan will support the Government's air quality policy reform and institutional strengthening. The project loan and the credit line will provide funds for public and private sectors in JABOTABEK to develop and improve hardware and software facilities required for better enforcement of and compliance with air quality regulations. Potential components may include capacity building for regulatory enforcement, air quality monitoring network, survey of stationary and mobile air pollution sources and their databases, enhancement of public awareness, adoption of cleaner energy and energy efficient technology by industry and transport sector, etc.

d. Expected results and deliverables:

Component A will provide funds to PGN and the private sector to set up (i) natural gas transmission pipelines, (ii) natural gas distribution network and connections to new CNG filling stations, (iii) CNG filling and storage stations, (iv) converter kits for existing gasoline cars, (v) new CNG-based buses, and (vi) stations for monitoring ambient air quality and vehicular emissions.

The policy loan of component B will help the Government to review and suggest amendments to the Air Pollution Act and Blue Sky Program. The associated air quality and emission standards and fuel specifications will also be reviewed and recommendations made to meet the objectives of safeguarding public health and improving living environment. Institutional framework in JABOTABEK for the enforcement of the Air Pollution Act will be reviewed and strengthened. The project loan and the credit line will help public and private sector to add new and augment equipment and databases essential for air quality improvement, and other cleaner energy and energy-efficient technology. The experience gained from the program will be able to be replicated in other provinces.

e. Social or environmental issues or concerns:

The program will strengthen the Government's policy and enforcement skill for air quality management, and improve air quality in urban and industrial areas. The urban residents, particularly the poor, will be benefited from the improvement of air quality. Productivity will also be improved due to the use of energy-efficient technology and better public health resulting from better air quality.

f. Plans for disseminating results/deliverables: TBD

<p>7. Proposed executing/implementing agencies: Executing Agency: MIGAS (component A), BAPPENAS/MOE (component B) Implementing Agency: PGN (component A), Governments of DKI Jakarta, Bogor, Tangerang and Bekasi, and related sectoral agencies (component B)</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: The program will be based on ongoing Blue Skies Program and consultations will be held with the stakeholders during preparation.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP update, SCSP, SCSP update, or interregional work plan: 2003</p> <p>b. Expected date of submission for approval Lending: 2008 Nonlending (project preparatory): 2006 Nonlending (other than project preparatory):</p> <p>c. Period and duration of assistance Lending: 2008-2011 Nonlending: 2007, 6 months</p>
<p>10. Financing Plan (Indicate possible financing sources and amount of assistance, cost estimates, and financing arrangements)</p> <p>a. For lending <input type="checkbox"/> Ordinary capital resources: <input type="checkbox"/> Asian Development Fund: <input type="checkbox"/> Other:</p> <p>b. For nonlending <input type="checkbox"/> No resources required, other than ADB staff <input type="checkbox"/> ADB's administrative budget: <input checked="" type="checkbox"/> Grant TA funds: TASF \$300,000 <input type="checkbox"/> Other:</p>

ADB = Asian Development Bank, CSP = country strategy and program, SCSP = subregional cooperation strategy and program, TA = technical assistance.

**Table A8.3: Legal and Administrative Framework for Land Acquisition and Resettlement
Concept Paper**

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input checked="" type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input checked="" type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>	
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Law, economic management, and public policy Subsectors: National and subnational government administration</p> <p>b. For project preparatory and lending, classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p><input type="checkbox"/> Sustainable economic growth</p> <p><input type="checkbox"/> Inclusive social development</p> <p><input checked="" type="checkbox"/> Governance</p> <p><input type="checkbox"/> Gender and development</p> <p><input type="checkbox"/> Environmental sustainability</p> <p><input type="checkbox"/> Regional cooperation</p> <p><input type="checkbox"/> Private sector development</p> <p>Subtheme: Public governance</p>	
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional <input type="checkbox"/> Internal policy development</p>	
<p>4. Responsible division/department: Infrastructure Division, South East Asia Regional Department</p>	
<p>5. Responsible ADB officer: M. Huddleson</p>	
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The proposal for TA complements the Indonesia country program emphasis on improving governance, including legal and judicial reform, building human capital, and, within ADB's program of assistance, improving aid effectiveness, within the overall context of decentralization. It also complements other country-specific regional initiatives to enhance policy, legal, and administrative frameworks for involuntary resettlement. The TA follows on from a key regional activity, RETA 5935 (2000-2002), in which Indonesia was a participant. The decentralization process under way since 1 January 2001 applies also to land acquisition and resettlement. This will necessitate attention to the planning, financing, approval, implementation, management, and monitoring for land acquisition and resettlement at the regional level if ADB infrastructure projects (and other investment projects) are to proceed without bottlenecks and delays. This requires a careful analysis of the relative roles and responsibilities of the central Government compared with the regional governments for land acquisition and resettlement matters. Under decentralization, the central Government retains the right to stipulate the requirements and standards for granting land titles, for land reform, for land administration, land service charges, and the national cadastral basic framework. BPN, the National Land Agency, has responsibility for three major land law revisions, including the Law on Land Acquisition and the Agrarian Law. Regions will make their own regulations on land use and their own arrangements for land registration and other matters, and, it appears, would generally be responsible for land acquisition, compensation and financing. The regions would need assistance to build</p>	

capacity to plan, budget for and manage land acquisition and resettlement.

b. Goal and purpose:

The overall goal is to improve living standards and to reduce the risks of impoverishment through development induced displacement by setting standards in accordance with good international practice, supported by sound planning and consistent policy implementation. The purpose is to assist BPN and the regional governments to develop appropriate legal and regulatory documents on land management, land acquisition and resettlement, in the context of decentralized responsibility, and to build capacity at the regional level to plan and manage land acquisition and resettlement. This will help to reduce the risks and to streamline the preparation and implementation of ADB and other nationally and internationally financed projects involving new construction or significant rehabilitation.

c. Components and outputs:

The TA will, first, support the emerging framework for decentralized environmental and land acquisition planning and management, assisting the central Government to enhance the requisite national policies and standards for regional projects. This includes the finalization and approval of a law on land acquisition, which BPN has endorsed, through a process of consultation with key stakeholders at national and regional level. Second, the TA would facilitate the changes in function, organization, staffing, and capabilities required at the local government level to enable local government units (LGU) to perform against the revised mandates for land related matters. Third, it will increase awareness and strengthen the capacity of LGUs to implement and monitor the revised policy and regulatory framework. Fourth, it will build in-country capacity to conduct social and resettlement assessments, monitoring and evaluation for ADB-financed projects during preparation and implementation, covering social assessment and resettlement. This will strengthen the supervision capacity of LGUs, and contribute to meet strategic objectives.

d. Expected results and deliverables:

Revised and enacted Land Acquisition Law, in accordance with Laws 22 and 25/1999 and related laws and regulations, through consultation and workshops with central and level-I and -II governments, and other key stakeholders.

Regulations for the issuance of the implementation guidelines that would be used for developing decentralized land acquisition and resettlement planning and management at the regional level.

Strategies developed and implemented for capacity building to strengthen local government organizational capabilities for planning, managing and monitoring resettlement activities, for financing these activities, and for formulating and supervising consultant contracts for specialized services, in line with the new law and other regulations and implementation guidelines.

Capacity building plans to strengthen NGOs, universities, and research centers in conducting independent environmental and social assessments and in designing appropriate monitoring and evaluation systems for resettlement plans.

e. Social or environmental issues or concerns:

The TA will directly address ADB's poverty reduction strategy, which is central to the Indonesia country strategy, by reducing impoverishment risks in displacement. It also supports a key ADB social safeguard policy on involuntary resettlement. The TA addresses important gaps between the existing policy and legal framework for land acquisition with ADB's policy on involuntary resettlement, which reflects international standards. Presidential Decree 55/1993 and a related Government Regulation 51 of 1993 on Environmental Impact Assessment do not sufficiently cover the principles of replacement costs for compensation for losses (NJOP and local government assessment may result in compensation far below market rates); census survey as a basis to prepare a plan; specificity in relocation and rehabilitation options, especially for the severely affected or vulnerable; compensation coverage for those affected persons with lesser, customary or with no formal land title; consultation, monitoring and evaluation; and coverage for private sector projects. Legal coverage is limited for sustainable alternative arrangements in cases where people affected face restricted access to depleted resources (for example, to national parks).

f. Plans for disseminating results/deliverables: BPN at the national level, and the regional governments would be responsible for disseminating the law, regulations, and guidelines developed under the TA. The institutions involved in capacity building work would also disseminate key documents through training and networking activities.

7. Proposed executing/implementing agencies: National Land Agency.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP update, RCSP, RCSP update, or interregional work plan: 2002
- b. Expected date of submission for approval
 Lending:
 Nonlending (project preparatory):
 Nonlending (other than project preparatory): 2004
- c. Period and duration of assistance
 Lending:
 Nonlending: 2004, 6 months

10. Financing Plan

- a. For lending
- Ordinary capital resources:
 - Asian Development Fund:
 - Other: Grant-based cofinancing \$ -

If cofinancing is required indicate sources, and amount sought:

If known, provide cost estimates and financing arrangements. (e.g., total cost, ADB financing, other financing, and government financing):

- b. For nonlending
- No resources required, other than ADB staff
 - ADB's administrative budget: \$
 - Grant TA funds: \$ 600,000

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance, BPN = National Land Agency.

**Table A8.4: Strengthening Capacity to Improve Aid Effectiveness
Concept Paper**

Date: August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p> <input type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input checked="" type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input checked="" type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sectors: Law, Economic Management and Public Policy Subsectors: Public Finance and Expenditure Management</p> <p>b. Targeting classification</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme(s): Institutional development</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Indonesia Resident Mission</p>								
<p>5. Responsible ADB officer: Barend Frielink</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The portfolio of overseas development assistance consists of 182 programs and projects with a total commitment of \$15.3 billion, of which over \$9.0 billion had not yet been disbursed by the end of 2005. While working to reduce the national debt stock from 50.0% of GDP to 31.8% of GDP in 2009, the Government will strengthen partnerships with multilateral and bilateral development institutions to achieve the goals of the national development plans and strategies. It is the intention of the Government to focus foreign development assistance on four thematic areas of the national development plan: (i) education and health; (ii) job creation, investment, and export generation (including infrastructure development);</p>								

(iii) revitalization of agriculture, fisheries and rural development; and (iv) poverty reduction.

BAPPENAS plays a critical role in coordinating national development planning and monitoring and evaluation processes. Law 25/2004 on the National Development Planning System provides BAPPENAS with the mandate to serve as the leading government institution responsible for national development planning. It also provides BAPPENAS with the institutional mandate to assist the President, the governors, and district heads to formulate the national and regional development strategies and to monitor and evaluate their implementation. National development strategies and plans are key references in working to align international development assistance with national priorities and strengthen national ownership in line with the Paris Declaration.

Government Regulation 2 of 2006 specifies the roles, responsibilities, and institutional mechanisms for coordination of international loan and grant assistance. While many sectoral departments are involved in implementing programs and projects supported by international development assistance, BAPPENAS and the Ministry of Finance play central coordinating roles in the program cycle for all international development assistance. There is a critical need to strengthen the approach to national coordination of development assistance and to establish a supporting information system to provide decision makers with information on development programs on a timely basis.

b. Goal and purpose: Goal: Improve effectiveness of ODA in line with the Paris Declaration. Purpose: Assist the Government to achieve a greater alignment of ODA with Government priorities, assist in strengthening the linkages between planning and budgeting, and improve monitoring and evaluation of projects funded by ODA.

Components and outputs: (i) An action plan to improve aid effectiveness. The action plan will be prepared based on a series of diagnostic assessment of the existing regulations, procedures, and practices applied in the program/project cycle for development assistance. (ii) A results-oriented performance assessment framework and management information system. (iii) Short-term domestic and international training, and workshops.

c. Rationale and purpose of ADF grant financing N.A.

d. Expected results and deliverables: A 5-year action plan to improve aid effectiveness, containing specific time-bound actions with full ownership of BAPPENAS and key departments. A comprehensive manual covering all phases of the project cycle, a database to enable project monitoring, a cadre of staff members who have been trained and are able to use the manuals and database effectively.

d. Social or environmental issues or concerns: None

e. Plans for disseminating results/deliverables:

For TA, method(s) of TA output dissemination

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify)

7. Proposed executing/implementing agency or agencies: BAPPENAS, Directorate for Multilateral Financing

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

Concept was developed by IRM together with BAPPENAS. Various workshops and seminars have been held within the agency to ensure full support.

9. Timetable for assistance design, processing, and implementation

a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006

b. Expected date of submission for approval

Lending:

Nonlending (project preparatory):

Nonlending (other than project preparatory): Q4, 2006

c. Period and duration of assistance

Lending:
Nonlending: 18 months

10. Financing Plan

For nonlending

- No resources required, other than ADB staff
- ADB's administrative budget:
- Grant TA funds
- Other:

Source	Amount (\$)
ADB Financing	800,000
Government Financing	200,000
Other Financing	0
Total Cost	1,000,000

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A8.5: Regional Road
Concept Paper**

Date: 10 August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input checked="" type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other: Capacity Building</p>								
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sectors: Transport and communications Subsectors: Road and highways</p> <p>b. For project preparatory and lending, classification</p> <p><input type="checkbox"/> Core poverty intervention</p> <p><input type="checkbox"/> Poverty intervention</p> <p><input type="checkbox"/> Other</p> <p>c. Key thematic area(s)</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input checked="" type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td></td> </tr> </table>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input checked="" type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input checked="" type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development								
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input checked="" type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Infrastructure Division/Southeast Asia Department</p>								
<p>5. Responsible ADB officer: J. M. Miller</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: Roads account for the major share of domestic freight and inter-urban passenger land travel, and their coverage and condition are crucial to supporting economic growth and social development. Road density, at 0.19 kilometers (km) per km² or 1.7 km per 1,000 people, is among the lowest in Southeast Asia. While there were substantial investments in road network upgrading and expansion in the 1980s and 1990s, sector expenditures have sharply fallen since the Asian financial crisis, from a peak of around 22% of the overall public budget in mid-1990s to about 10% in recent years. National arterial roads are in a relatively good condition, but almost half are congested, pushing up costs for industry and trade, and the network comprises only about 600 km of high-grade toll roads. Provincial roads are also generally well preserved, but district and urban roads are in a poor condition, with upward of 30% of them unpaved thus restricting all-season access. In terms of spending, there has been a fairly good preservation of national arterial</p>								

roads but a growing backlog of investments in network improvement and extension. The situation has been the opposite at the regional level, with under-spending on preservation having a more negative impact than under-spending on road development.

Overall, the available road network is inadequate, but in relative terms the district/rural road network is vastly inadequate and also in worse condition in terms of quality. While the national road network is also inadequate, the quality of new or maintained roads is not bad. The problems of the adequacy and quality of infrastructure result in congestion, delays, high operating costs, and poor safety. The main problem is lack of regular maintenance of the road network. Other causes include overloading of vehicles, demand/capacity imbalance, lack of funding, lack of productivity and management, and weak and uncoordinated institutions.

b. Goal and purpose: The main objective of the TA is to prepare a project that will provide the infrastructure to facilitate the movement of freight and passengers on the national highway network.

c. Components and outputs: The project's outputs will include (i) socioeconomic analysis of the region; (ii) traffic studies; (iii) preliminary design of regional roads; (iv) economic feasibility studies of the proposed roads; (v) assessment of the institutional capacity of the executing agency; (vi) social/poverty assessment, land acquisition and resettlement plan, and indigenous peoples development plan; (vii) environmental assessment; and (viii) preparation of project processing documentation.

d. Expected results and deliverables: The project will result in improved, sustainable, and efficient regional roads investment and operation.

e. Social or environmental issues or concerns: To be addressed during TA implementation

f. Plans for disseminating results/deliverables: Tripartite meetings, ADB website

7. Proposed executing/implementing agency or agencies: Ministry of Public Works

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

9. Timetable for assistance design, processing, and implementation

a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006

b. Expected date of submission for approval
 Lending:
 Nonlending (project preparatory): 2007
 Nonlending (other than project preparatory):

c. Period and duration of assistance
 Lending:
 Non-lending: 2007–2008

10. Financing Plan

- a. For nonlending
- No resources required, other than ADB staff
 - ADB's administrative budget: \$
 - Grant TA funds
 - Other:

Source	Amount (\$)
ADB Financing	700,000
Government Financing	100,000
Other Financing	
Total Cost	800,000

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

Table A8.6 Flood Management in Selected River Basins in Java (Supplementary)

Date:

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> Other: {specify, e.g., loan-financed project preparatory, project implementation, or advisory activities}</p> <p><input type="checkbox"/> Nonlending</p> <p><input checked="" type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other: {specify}</p>										
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Agriculture and natural resources, and Environment. Subsector: Water resources management.</p> <p>b. For project preparatory and lending, classification</p> <p><input type="checkbox"/> Core poverty intervention</p> <p><input type="checkbox"/> Poverty intervention</p> <p><input checked="" type="checkbox"/> Other Development Institution</p> <p>c. Key thematic area(s) {check more than one category, if applicable}</p> <table border="0"> <tr> <td><input type="checkbox"/> Economic growth</td> <td><input type="checkbox"/> Human development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Good governance</td> </tr> <tr> <td><input checked="" type="checkbox"/> Environmental protection</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Regional cooperation</td> <td><input type="checkbox"/> Social protection</td> </tr> <tr> <td><input type="checkbox"/> Other: {specify}</td> <td></td> </tr> </table>	<input type="checkbox"/> Economic growth	<input type="checkbox"/> Human development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance	<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection	<input type="checkbox"/> Other: {specify}	
<input type="checkbox"/> Economic growth	<input type="checkbox"/> Human development									
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Good governance									
<input checked="" type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development									
<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection									
<input type="checkbox"/> Other: {specify}										
<p>3. Coverage:</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional <input type="checkbox"/> Internal policy development</p>										
<p>4. Responsible division/department: Agriculture, Natural Resources, and Environment division, Southeast Asia Regional Department.</p>										
<p>5. Responsible ADB officer: C. Morris</p>										
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy:</p> <p>Recurrence of major floods have increased on Java in recent years, with heavy losses to the economy. The effectiveness of fragmented flood control works has been reduced, necessitating an integrated approach to flood management within a river basin. In addition to improving the flood discharge carrying capacity of the river and protecting vulnerable sites from erosion through structural measures, the impact of watershed denudation and the loss of natural flood retention areas and drainage routes to urban and industrial belts and infrastructure need to be assessed and corrective measures built in the flood management plan.</p> <p>Preparatory works initiated by DGWR are at initial stage of assessment on watershed based on satellite imageries in progress. ADB has been involved in water resource development, including flood control in major river basis, on Java.</p> <p>b. Goal and purpose:</p>										

<p>The project will provide for preparation and phased implementation of a comprehensive flood management program, taking into account the spatial dimensions of the existing and future development activities within the basin.</p> <p>c. Components and outputs: TBD</p> <p>d. Expected results and deliverables: TBD</p> <p>e. Social or environmental issues or concerns: Unsustainable economic activities in the watershed by local communities, and legal and management issues relating to lands designated within forest estates.</p> <p>f. Plans for disseminating results/deliverables: TBD</p>
<p>7. Proposed executing/implementing agencies: Ministry of Public Works, Directorate General of Water Resources</p>
<p>8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: Consultation is held with central Government, regional governments, and community members.</p>
<p>9. Timetable for assistance design, processing, and implementation</p> <p>a. Year included in CSP, CSP update, SCSP, SCSP update, or interregional work plan: 2002</p> <p>b. Expected date of submission for approval Lending: 2008 Nonlending (project preparatory): Nonlending (supplementary): 2007</p> <p>c. Period and duration of assistance(s) Lending: 2008-2011 Nonlending: 2004-2006.</p>
<p>10. Financing Plan</p> <p>a. For lending</p> <p><input type="checkbox"/> Ordinary capital resources:</p> <p><input type="checkbox"/> Asian Development Fund: \$</p> <p><input type="checkbox"/> Other:</p> <p>If cofinancing is required indicate sources, and amount sought: If known, provide cost estimates and financing arrangements. (e.g., total cost, ADB financing, other financing, and government financing):</p> <p>b. For nonlending</p> <p><input type="checkbox"/> No resources required, other than ADB staff</p> <p><input type="checkbox"/> ADB's administrative budget: \$</p> <p><input checked="" type="checkbox"/> Grant TA funds: \$1,200,000</p>

**Table A8.7: HIV in the Transport Sector
Concept Paper**

Date: 7 August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input checked="" type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input checked="" type="checkbox"/> Institutional development</p> <p> <input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Transport and Communications; health, nutrition, and social protection Subsector(s): ports, waterways, and shipping; roads and highways; health and social services attached to wider programs.</p> <p>b. Targeting classification</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input checked="" type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subthemes: Fostering Physical Infrastructure Development, Regional Gender Initiatives, Institutional Development</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input checked="" type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input checked="" type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Indonesia Resident Mission</p>								
<p>5. Responsible ADB officer: Lisa Kulp</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: The CSP focuses on acceleration of MDG achievement and Infrastructure development. Millennium Development Goal 6 is to combat HIV/AIDS, Malaria, and other diseases. The 2007 National Government Work Program (RKP) has identified reducing the spread of HIV/AIDS as a major issue. Groups that are vulnerable to HIV/AIDS include mobile workers including construction workers. Construction workers comprise 5 percent of the total labor force and are generally beyond the reach of residence based programs carried out by the Ministry of Health. The National Aids Commission is responsible for setting HIV/AIDS strategy. The Ministry of Labor and Transmigration issued a decree on HIV/AIDs awareness in the work place, The Ministry of Public Works, however, regulates construction services and has the mandate to regulate work conditions and standards for construction workers engaged on both public and privately financed projects. Construction workers, sizable and high risk population can be reached through the Ministry of Public Works by developing the capacity of the Construction Services and Human Resource Development Board (BKPSDM) to advocate HIV/AIDS awareness as a part of occupational health and safety standards and training</p>								

for construction workers.

b. Goal and purpose: Goal: Enhance HIV/AIDS Awareness among high risk mobile workers. Purpose: Assist Ministry of Public Works BPKSDM to include and implement HIV/AIDS Awareness Training as part of national occupational health and safety requirements accreditation and training for high HIV risk construction projects. High risk projects include, among others, including labor intensive projects, large fixed capital intensive works, and projects in remote areas.

c. Components: Component 1: establish a policy and institutional framework; Component 2: Building capacity of BPKSDM to advocate and implement HIV/AIDS training as part of occupational health and safety training for Public Works staff and construction service providers (companies, staff, and laborers); Component 3: Pilot Implementation of HIV/AIDS awareness training.

d. Rationale and purpose of ADF grant financing: N/A

e. Expected results and deliverables:

BPKSDM has mandate and capacity to carry out HIV/AIDS awareness training: Ministerial Decree on Strategy for HIV/AIDS Awareness Strategy in the Construction Service Sector; training modules, Training of Trainers, training program for 2007 and 2008 for training PU and Construction sector staff and workers in HIV/AIDS Awareness

Increased awareness among Public Works staff responsible for construction projects and among construction service providers and their workers: Public Works staff and construction service providers, workers, and laborers trained

f. Social or environmental issues or concerns: None

g. Plans for disseminating results/deliverables:

For TA, method(s) of TA output dissemination

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify) _TA outputs included in Public Works Occupational Health and Safety Training Packages for Construction Service Providers.

7. Proposed executing/implementing agency or agencies: Agency for Construction and Human Resource Development, Ministry of Public Works

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: Extensive discussions with the Ministry of Public Works, National Aids Commission, Yayasan Kusuma Buana, Construction Services Development Board (CSDB), Association of Construction Service Providers, DKT International, ILO,

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006
- b. Expected date of submission for approval
 - Lending:
 - Nonlending (project preparatory):
 - Nonlending (other than project preparatory): Q1 2007
- c. Period and duration of assistance
 - Lending:
 - Nonlending: 24 months

10. Financing Plan

- a. For lending
 - Ordinary capital resources:

- Asian Development Fund (loan):
- Asian Development Fund (grant):
- Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

Source	Amount (\$ million)
ADB Financing	
Government Financing	
Other Financing	
Total Cost	

Source:

- b. For nonlending
- No resources required, other than ADB staff
 - ADB's administrative budget:
 - Grant TA funds
 - Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

Source	Amount (\$ million)
ADB Financing	800,000
Government Financing	200,000
Other Financing	0
Total Cost	1,000,000

Source:

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A8.8: Second Neighborhood Upgrading and Shelter Sector Project (NUSSP II)
Concept Paper**

Date: 10 August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input checked="" type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p> <p><input type="checkbox"/> Activities financed by JFICT or JFPR</p>										
<p>2. Assistance Focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Industry and Trade Subsector: Housing Construction</p> <p>b. For project preparatory and lending,</p> <p><input type="checkbox"/> Core poverty intervention</p> <p><input checked="" type="checkbox"/> Poverty intervention</p> <p>c. Key thematic area(s)</p> <table border="0"> <tr> <td><input type="checkbox"/> Economic growth</td> <td><input checked="" type="checkbox"/> Human development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Good governance</td> </tr> <tr> <td><input type="checkbox"/> Environmental protection</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Regional cooperation</td> <td><input type="checkbox"/> Social protection</td> </tr> <tr> <td><input type="checkbox"/> Other:</td> <td></td> </tr> </table>	<input type="checkbox"/> Economic growth	<input checked="" type="checkbox"/> Human development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Good governance	<input type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection	<input type="checkbox"/> Other:	
<input type="checkbox"/> Economic growth	<input checked="" type="checkbox"/> Human development									
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Good governance									
<input type="checkbox"/> Environmental protection	<input type="checkbox"/> Private sector development									
<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Social protection									
<input type="checkbox"/> Other:										
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>										
<p>4. Responsible division/department: Social Sectors Division, Southeast Asia Regional Department</p>										
<p>5. Responsible ADB officer: F. Steinberg, A. Weitz</p>										
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The TA will address poverty reduction by designing a project to upgrade informal settlements through support to community infrastructure improvement and the continued support to a housing finance system which will become available to the urban poor. The TA will also design support to build capacity for financial institutions to serve this segment of poor population which lives in informal settlements, deprived of many services, without safe tenure of land, and without easy access to finance for home improvement.</p> <p>b. Goal and purpose: The project supports the Government's urban poverty reduction strategy by creating sustainable mechanisms for (i) providing resources to local governments, in partnership with communities, for upgrading and tenure provision in settlement of poor informal settlers which are lacking services and infrastructure, and unstable tenure conditions; (ii) expanding the access of poor urban informal settlers to microcredit for shelter finance; and (iii) facilitating participatory community-driven planning by strengthening the</p>										

role and capacity of participating communities, local governments, and the Directorate General of Human Settlements (DGHS) (Cipta Karya) of the Ministry of Public Work to meet its responsibilities. The Project will also contribute to establish a conducive policy, institutional, and regulatory environment to meet the housing needs of urban poor communities in informal settlement areas.

c. Components and outputs: The TA will conduct an overview of the sector, taking into account developments and achievements under the first NUSSP, and recommend appropriate further structural reforms, and extend further assistance to the institutions which have started to implement NUSSP. The TA will propose the scale and scope for ADB assistance.

c. Expected results and deliverables: The project will support the poverty reduction goals of the Government and ADB, and will improve the quality of life of urban informal settlers. In the envisaged settlement upgrading subprojects, land ownership issues will be resolved and individual titles or other forms of secure tenure will be made available. Nearby communities will indirectly benefit from the provision of off-site infrastructure, including flood protection facilities, main roads, and main drainage systems. Similar cases of site improvement have been shown to increase the market value of land by about 200–700%. Significant gains will accrue to the implementing agencies (in the form of increased revenues from property taxes) as well as end beneficiaries (in the form of better social, financial, and economic status).

d. Social or environmental issues or concerns: The health situation for the beneficiaries will improve substantially because of improved environmental conditions.

f. Plans for disseminating results/deliverables: The project, the second project of this kind, aims to contribute to national coverage of the NUSSP.

7. Proposed executing/implementing agencies:

Directorate General of Human Settlements (DGHS) (Cipta Karya) of the Ministry of Public Works (MW)

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

TBD

9. Timetable for assistance design, processing, and implementation

a. Year included in CSP, CSP update, SCSP, SCSP update, or interregional work plan: 2007

b. Expected date of submission for approval
 Lending:
 Nonlending (project preparatory): 2008/2009
 Nonlending (other than project preparatory):
 Activities financed by JFICT or JFPR:

c. Period and duration of assistance
 Lending:
 Nonlending: 2007
 Activities financed by JFICT or JFPR:

10. Financing Plan (Indicate possible financing sources and amount of assistance, cost estimates, and financing arrangements)

- b. For nonlending
- No resources required, other than ADB staff
 - ADB's administrative budget: \$
 - Grant TA funds
 - TA Special Fund: \$1,000,000
 - Japan Special Fund: \$
 - Other (specify, e.g., bilateral and multilateral trust funds):

If cofinancing is required indicate sources, and amount sought:

If known, provide cost estimates and financing arrangements. (e.g., total cost, ADB financing, other financing, and government financing):

ADB = Asian Development Bank, CSP = country strategy and program, JFICT = Japan Fund for Information and Communication Technology, JFPR = Japan Fund for Poverty Reduction, SCSP = subregional cooperation strategy and program, TA = technical assistance.

**Table A8.9: Investment Climate, Finance, and Policy Reform Cluster
Concept Paper**

Date: 9 August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input type="checkbox"/> Other than project preparatory</p> <p><input checked="" type="checkbox"/> Economic, thematic, and sector work</p> <p><input type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sectors: Multisector: finance; law, economic management, and public policy. Subsectors: Financial sector development, national government administration, subnational government administration.</p> <p>b. Targeting classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area</p> <p>Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input type="checkbox"/> Capacity development</td> </tr> </table> <p>Subthemes: Promoting economic efficiency and enabling markets, financial and economic governance, public governance, policy/institutional/legal/regulatory reforms, private sector investment</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Governance, Finance, and Trade Division, Southeast Asia Department</p>								
<p>5. Responsible ADB officer: V. Subramanian</p>								
<p>6. Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy</p> <p>Indonesia will have to significantly increase its level of investment as well as allow for more efficient allocation of capital if it is to attain higher growth and make notable progress in reducing poverty. This will require effective addressing of a range of issues affecting the overall investment climate (Indonesia's investment climate consistently compares poorly to regional comparators in regular surveys) as well as development of a financial sector more able to effectively mobilize capital and efficiently allocate it (it has one of the smallest financial sectors in relation to GDP in the region). The 2006-2009 CSP identifies (i) lack of depth and diversification of the financial sector, and (ii) adverse investment climate as core constraints to higher economic growth. The TA will provide for (i) identification of key issues, stakeholders, and interests in these two areas; (ii) development of a coherent and realistic strategy to address the issues; and (iii) the translation of the strategy into a proposal for a sequenced package of policy reforms.</p>								

b. Goal and purpose: In collaboration with the Government, the TA will identify a package of short- and medium-term reforms aimed at increasing the level of investment as well as the efficiency of its allocation through financial sector development (with particular regard to the nonbank financial sector) and improvements to the overall investment climate.

c. Components and outputs: (i) Background paper identifying key issues, stakeholders, and interests; (ii) strategy paper identifying key reforms needed to address issues and realistic options for achieving these; (iii) workshops aimed at building stakeholder support for proposed reforms; and (iv) proposal for a sequenced package of policy reforms.

d. Rationale and purpose of ADF grant financing: Not applicable

e. Expected results and deliverables: A proposal centered on a coherent, well-sequenced package of reforms in support of (b) that are feasible over the short to medium term.

f. Social or environmental issues or concerns: None

g. Plans for disseminating results/deliverables:
For TA, method(s) of TA output dissemination:

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify)

7. Proposed executing/implementing agency or agencies: Executing Agency: Coordinating Ministry for Economic Affairs; Implementing agencies: Bapepam-LK, Investment Coordinating Board, Ministry of Industry, Ministry of Home Affairs

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:
 The assistance will support two clearly identified Government priorities: (i) improving the investment climate, and (ii) financial sector development.

9. Timetable for assistance design, processing, and implementation

a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2007

b. Expected date of submission for approval
 Lending:
 Nonlending (project preparatory): February 2007
 Nonlending (other than project preparatory):

c. Period and duration of assistance
 Lending:
 Nonlending: 12 months. March 2007 – February 2008

10. Financing Plan

a. For lending

- ordinary capital resources:
- Asian Development Bank Fund (loan):
- Asian Development Bank Fund (grant):
- Other:

If cofinancing is required, indicate amount and sources sought: \$_____, from _____.

b. For nonlending

- No resources requested, other than ADB staff
- ADB's administrative budget
- Grant TA funds: \$800,000
- Other:

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A8.10: Physical Infrastructure Development Cluster
Concept Paper**

Date: 10 August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p><input type="checkbox"/> Project loan</p> <p><input type="checkbox"/> Program loan</p> <p><input type="checkbox"/> Sector loan</p> <p><input type="checkbox"/> Sector development program loan</p> <p><input type="checkbox"/> ADF grant-financed</p> <p><input type="checkbox"/> Other:</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input checked="" type="checkbox"/> Other than project preparatory</p> <p><input checked="" type="checkbox"/> Economic, thematic, and sector work</p> <p><input checked="" type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector(s): Multi Sector Subsector(s):</p> <p>b. Targeting classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s) Themes:</p> <table border="0"> <tr> <td><input checked="" type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input checked="" type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme): Fostering physical infrastructure development</p>	<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input checked="" type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input type="checkbox"/> Governance	<input checked="" type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>								
<p>4. Responsible division/department: Infrastructure Division/Southeast Asia Regional Department</p>								
<p>5. Responsible ADB officer: S. Gupta and J. Miller</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: The Indonesian economy is poised to grow at 6-7% and lack of adequate physical infrastructure will be one of main bottlenecks that threaten the take-off of the Indonesian economy. The estimated infrastructure investment requirements till 2010 exceed \$140 billion. Most of these investments will have to come from the private sector. The Government has to leverage its limited resources to attract private investment in the desired sectors. To achieve the objectives of the CSP includes engagement in infrastructure to augment the quality and quantity of public sector investments and to create an enabling environment for the private sector.</p>								

Institutional problems in the transport sector include lack of sector coordination both internally and with other sectors, weak capacity and institutions, and lack of appropriate laws and regulations. The overlap in responsibilities for development and maintenance of road assets between the Ministry of Public Works and Ministry of Transport needs to be addressed. While asset management capacity has been built up at the national level, development planning needs strengthening. Regional agencies vary considerably in capacity and performance, and inter-agency coordination is weak. Heavy-vehicle overloading is prevalent, significantly increasing road preservation costs, and road safety is poor. The implementation of road works is often expensive and of low quality, and collusion among contractors is a problem. The business practices and performance of the national agencies and the construction industry need to be improved, and capacity of the regional agencies built up. Regulatory enforcement to reduce vehicle overloading needs to be strengthened, and a comprehensive road safety program implemented.

The Government has recognized the need to undertake performance-based budgeting (PBB) in the infrastructure sectors to ensure effective planning and programming of infrastructure development, including assessing projects submitted to BAPPENAS for the "Bluebook". The transport sector has developed subsector blueprints under the Infrastructure Reform Program (IRP) but coordination and assessment have not been effective, and the need to compare different modes and projects for development is crucial. BAPPENAS transport directorate intends to operationalize PBB through the establishment of a multimodal coordination database system (MCDS) that will allow for the effective management and prioritizing of transport infrastructure investments, for public and PPP projects.

b. Goal and purpose: The purpose of the TA is to contribute to improved infrastructure and infrastructure services, including rural infrastructure, with increased public and private sector investments. The objective of the proposed MCDS is to establish a planning tool in BAPPENAS transport directorate that will be used to assess the viability of transport projects, assess competing multimodal developments along transport corridors and develop transport indicators at national and provincial government levels. The MCDS will provide the baseline data to allow effective evaluation and monitoring of transport project outputs through sustainable transport indicators.

c. Components and outputs: The TA will comprise broad clusters:

- cluster I – assistance with implementing rules for existing infrastructure decrees and regulations, and providing inputs for new regulations, for example, an integrated strategy for development of coal bed methane (CBM);
- cluster II – support development of new and emerging energy alternatives, for example, development of the renewable and biofuels program in Indonesia and CBM;
- cluster III – identify projects that contribute to an efficient regional infrastructure system, for example, transborder pipelines, transmission lines and roads that contribute to the development of the ASEAN infrastructure grid; and
- cluster IV – capacity building and institutional strengthening of key government institutions to facilitate private sector investment.
- cluster V – capacity building and institutional strengthening of transport sector institutions to improve sector coordination both internally and with other sectors, asset management capacity, development planning, road safety, and business practices and management.
- cluster VI –MCDS, including (i) providing software and hardware tools to BAPPENAS; (ii) strengthening existing computer based systems such as the integrated road management system (IRMS); (iii) improving other establishing department level systems; and (iv) institutional strengthening to BAPPENAS, transport ministries and state-owned enterprise (SOE) staff for MCDS operation.

d. Rationale and purpose of ADF grant financing: Not applicable

e. Expected results and deliverables: The TA will be developed in close consultation with the Government, to ensure a sense of ownership and relevance. The outputs include and are not limited to the following:

- policies and strategies for extraction and transportation of CBM;
- development of a biofuel program;
- competitive and efficient energy pricing;
- capacity building of infrastructure regulators and clarity on areas of responsibility;
- identification and promotion of trans-border infrastructure projects that are mutually beneficial;
- improved transport sector coordination, asset management capacity, development planning, road safety, and business practices and management;
- MCDS, which will allow for BAPPENAS to more effectively plan and prioritize transport infrastructure investments, provide a basis to assess PSP in transport infrastructure projects, and provide a tool to assess and approve transport infrastructure projects, including donor-funded submissions.

f. Social or environmental issues or concerns: The TA will also focus on a review and assessment of the

environment, social and safety concerns associated with the development of infrastructure.

g. Plans for disseminating results/deliverables:

For TA, method(s) of TA output dissemination:

- A conference/workshop/brown bag
- Publication of article(s) in external journals or books
- External press release to news agencies, including www.adb.org
- Internal press release in *ADB Today*
- Others (specify) Training Program

7. Proposed executing/implementing agency or agencies: Infrastructure related agencies like the oil and gas regulator (BPH Migas and BP Migas), Directorate General for Electricity and Energy Utilization, PLN, Ministry of Public Works, Ministry of Transport

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance: Consultations with the government including BAPPENAS, Ministry of Finance, Ministry of Energy and Mineral Resources, Ministry of Public Works, and Ministry of Transport during CSP consultations.

9. Timetable for assistance design, processing, and implementation

- a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006
- b. Expected date of submission for approval
 - Lending:
 - Nonlending (project preparatory):
 - Nonlending (other than project preparatory): April 2007
- c. Period and duration of assistance
 - Lending:
 - Nonlending: June 2007 – May 2009 (24 months)

10. Financing Plan

- a. For lending
 - Ordinary capital resources: \$
 - Asian Development Fund (loan): \$
 - Asian Development Fund (grant): \$
 - Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

- b. For nonlending
 - No resources required, other than ADB staff
 - ADB's administrative budget:
 - Grant TA funds: \$2,000,000
 - Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A8.11: Support for Developing Disaster Risk Management
Concept Paper**

Date: August 2006

<p>1. Type/modality of assistance</p> <p><input type="checkbox"/> Lending</p> <p> <input type="checkbox"/> Project loan</p> <p> <input type="checkbox"/> Program loan</p> <p> <input type="checkbox"/> Sector loan</p> <p> <input type="checkbox"/> Sector development program loan</p> <p> <input type="checkbox"/> ADF grant-financed</p> <p> <input type="checkbox"/> Other</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p> <input type="checkbox"/> Project preparatory</p> <p> <input type="checkbox"/> Other than project preparatory</p> <p> <input type="checkbox"/> Economic, thematic, and sector work</p> <p> <input type="checkbox"/> Institutional development</p> <p> <input checked="" type="checkbox"/> Other: ADTA – advisory services to government</p>									
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Law, Economic Management and Public Policy Subsector: National Government Administration. Subnational Government Administration</p> <p>b. Targeting classification</p> <p> <input type="checkbox"/> Targeted intervention</p> <p> <input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area</p> <p>Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input checked="" type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Subtheme: Natural resources conservation; organizational development; client relations, network, and partnership development</p>		<input type="checkbox"/> Sustainable economic growth	<input checked="" type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input checked="" type="checkbox"/> Environmental sustainability								
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation								
<input type="checkbox"/> Governance	<input type="checkbox"/> Private sector development								
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development								
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p> <p><input type="checkbox"/> Internal policy development</p>									
<p>4. Responsible division/department Capacity Development and Governance Division, Regional and Sustainable Development Department</p>									
<p>5. Responsible ADB officer: N. Britton</p>									

6.	<p>Description of assistance(s)</p> <p>a. Background/linkage to country/regional strategy: Development and disaster-related policies have largely focused on emergency response, with serious under-investment in natural-hazard prevention and mitigation. An effective way to reduce losses from natural disaster is to integrate disaster risk into overall economic and development processes—that is, to mainstream disaster risk management (DRM). DRM has lately been elevated as an area of concern to the Government. The 2007 Government Work Plan has, for the first time, included hazard mitigation and disaster management as one of nine priority areas. Proposed legislation is expected to become law later this year, proposing a new disaster management agency that will see the current secretariat become the nation's first national-level policy and operational focal point. A national disaster reduction plan is under preparation that anticipates strategic realignment of functions within the Government. There is a widespread view that the Government's development partners will assist in the transition from the former reactive "disaster response" position to the new proactive "disaster risk reduction" approach. ADB is in a good position to assist. A key element in ADB's Disaster and Emergency Assistance Policy (DEAP) is institutionalizing DRM by identifying risks during country programming schedules, and building national hazard and disaster management capacity.</p> <p>b. Goal and purpose: The project will assist the National Disaster Management Agency (BAKORNAS) initiate the transition by providing advice and hands-on lessons learned from similar organizational arrangements and realignments elsewhere. The purpose is (i) to provide policy and advisory support at national and subnational levels for institutionalizing disaster risk management, and (ii) to furnish case studies of hazard management techniques in specific settings to illustrate its application.</p> <p>c. Components and outputs: The project comprises two major components dealing with interlinked outputs: (i) institutionalizing DRM by assisting BAKORNAS incorporate a disaster risk management approach, including helping to lay the groundwork for national–subnational linkages; and (ii) developing hazard management strategies by incorporating techniques developed in two infrastructural projects: (a) creating resilience in the madrasah school building project (see relevant documents), and (b) identifying parameters and investigating options for developing a total risk reduction regime for the Citarum River Basin Project (see relevant documents).</p> <p>d. Rationale and purpose of ADF grant: N/A</p> <p>e. Expected results and deliverables: The project will provide (i) guidance, feedback, workshops, and guidelines to BAKORNAS on options for developing disaster risk management within and between national-subnational agencies (ii) on-site assessment and training to enhance resilience in the construction techniques of community-led non-engineered buildings; and (iii) on-site assessment, choices and guidelines to institute a comprehensive multi-hazard management program for a specific location.</p> <p>f. Social or environmental issues or concerns: To be determined during fact-finding</p> <p>g. Plans for disseminating results/deliverables: Local consultations, workshops, training programs</p> <p>For TA, method(s) of TA output dissemination: To be determined</p> <p><input checked="" type="checkbox"/> A conference/workshop/brown bag</p> <p><input type="checkbox"/> Publication of article(s) in external journals or books</p> <p><input type="checkbox"/> External press release to news agencies, including www.adb.org</p> <p><input type="checkbox"/> Internal press release in <i>ADB Today</i></p> <p><input type="checkbox"/> Others (specify)</p>
7.	<p>Proposed executing/implementing agency or agencies: National Disaster Management Agency (BAKORNAS)</p>
8.	<p>Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:</p> <p>ADB carried out meetings with key Government agencies (BAKORNAS, BAPPENAS, Housing and Human Settlements Division—Ministry of Public Works, Directorate General of Water Resources, Ministry of Home Affairs) during the CSP process and received a consistent message that the Government expects its development partners to help the transition from the former reactive disaster response position to the more proactive disaster</p>

reduction/prevention approach. In particular, it was expected that infrastructure and capacity development projects would have a DRM component.

9. **Timetable for assistance design, processing, and implementation**

a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006

b. Expected date of submission for approval
 Lending:
 Nonlending
 Nonlending (other than project preparatory): 2007

c. Period and duration of assistance
 Lending:
 Nonlending: 6 months

10. Financing Plan

a. For nonlending

No resources required, other than ADB staff

ADB's administrative budget:

Grant TA funds

Other:

If cofinancing is required, indicate amount and sources sought: \$____, from _____.

Source	Amount (\$ million)
ADB Financing	600,000
Government Financing	150,000
Other Financing	0
Total Cost	790,000

Source: Asian Development Bank estimates.

ADB = Asian Development Bank, CSP = country strategy and program, RCSP = regional cooperation strategy and program, TA = technical assistance.

**Table A8.12: Support for Results Management in National Planning
Concept Paper**

Date: August 2006

<p>1. Type/modality of assistance</p> <p><input checked="" type="checkbox"/> Nonlending</p> <p><input type="checkbox"/> Project preparatory</p> <p><input checked="" type="checkbox"/> Other than project preparatory</p> <p><input type="checkbox"/> Economic, thematic, and sector work</p> <p><input checked="" type="checkbox"/> Institutional development</p> <p><input type="checkbox"/> Other:</p>								
<p>2. Assistance focus</p> <p>a. If assistance focuses on a particular sector or subsector, specify the Sector: Law, Economic Management, and Public Policy Subsector: Public Finance and Expenditure Management</p> <p>b. Targeting classification</p> <p><input type="checkbox"/> Targeted intervention</p> <p><input checked="" type="checkbox"/> General intervention</p> <p>c. Key thematic area(s)</p> <p>Themes:</p> <table border="0"> <tr> <td><input type="checkbox"/> Sustainable economic growth</td> <td><input type="checkbox"/> Environmental sustainability</td> </tr> <tr> <td><input type="checkbox"/> Inclusive social development</td> <td><input type="checkbox"/> Regional cooperation</td> </tr> <tr> <td><input checked="" type="checkbox"/> Governance</td> <td><input type="checkbox"/> Private sector development</td> </tr> <tr> <td><input type="checkbox"/> Gender and development</td> <td><input checked="" type="checkbox"/> Capacity development</td> </tr> </table> <p>Sub-theme{s}: Institutional development</p>	<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability	<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation	<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development	<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development
<input type="checkbox"/> Sustainable economic growth	<input type="checkbox"/> Environmental sustainability							
<input type="checkbox"/> Inclusive social development	<input type="checkbox"/> Regional cooperation							
<input checked="" type="checkbox"/> Governance	<input type="checkbox"/> Private sector development							
<input type="checkbox"/> Gender and development	<input checked="" type="checkbox"/> Capacity development							
<p>3. Coverage</p> <p><input checked="" type="checkbox"/> Country <input type="checkbox"/> Subregional <input type="checkbox"/> Interregional</p>								
<p>4. Responsible division/department: Indonesia Resident Mission</p>								
<p>5. Responsible ADB officer: Barend Frieling</p>								
<p>6. Description of assistance</p> <p>a. Background/linkage to country/regional strategy: Indonesia has successfully made the transition from an authoritarian state with centralized management of the economy, to a full-fledged democracy with a decentralized structure. Given the speed with which this transformation has taken place, especially in developing the necessary legal and regulatory framework, it is not surprising that the implementation of these reforms, and especially the required capacity development, would take more time. Yet, Indonesia is well on the way to introducing the important building blocks for results management. The commitment to results management is clearly reflected in the Law on State Finance (17/2003), which is the first law to provide the legal basis for performance-orientation in public sector resource management in Indonesia. The principal goal of the law is to improve efficiency, transparency, and accountability in the use of state finances. It aims to integrate macroeconomic planning and fiscal policy formulation, besides enhancing overall accountability of the budget process. The law requires each line ministry and budget institution to submit a work plan together with its budget proposal. Subsequently, Parliament also enacted the Law on State Treasury (1/2004) and Law on State Audit (15/2004). Together, this triumvirate of laws could potentially cover the ex-ante as well as the ex-post aspects of the full budget cycle. However, the norms and values for the effective implementation of these laws are lacking, as the civil service has not been subject to similar reforms and is firmly stuck in "business as usual", with little incentive to change. Full adoption of a functional PBM system is a formidable task, one that has been a challenge even in developed countries. In that sense, it is commendable that Indonesia has begun its transition toward PBM. While line ministries are submitting annual work plans, they</p>								

vary in quality and the level of detail. The transition toward a full PBM is likely to be long.

At the local level, performance standards have been issued as minimum service standards (MSS) for the decentralized functions. ADB has supported the process of developing these standards,¹ which are not yet operational more than 5 years into the decentralization process. Law 32/2004 stipulates that the obligatory functions assigned to local governments need to be evaluated against certain minimum service standards. The lack of clarity in the assignment of functions and concerns over fiscal constraints that may impede the attainment of MMS once they are mandated, have led to delays in developing the standards. This is also because MMS were originally conceived as administrative standards without links to the budget.

b. Goal and purpose: Goal: To introduce a results-based planning system. Purpose: To help the Government develop a process to move toward results-based planning, to be eventually applied in the next Medium-Term Plan 2010-2014.

c. Components and outputs: (i) Diagnostic study and gap analysis; (ii) establishment of a pilot project in one or two sectors; and (iii) Short-term domestic and international training, and workshops.

d. Rationale and purpose of ADF grant financing N.A.

e. Expected results and deliverables: A planning document that is formulated in terms of results and outcomes, with clear linkages to inputs and costs, and with monitoring indicators. This should focus only on one or two key sectors as a pilot.

f. Social or environmental issues or concerns: None

g. Plans for disseminating results/deliverables:

For TA, method(s) of TA output dissemination

A conference/workshop/brown bag

7. Proposed executing/implementing agency or agencies: National Development Planning Agency (BAPPENAS)

8. Nature/extent of government/beneficiary involvement in identifying or conceptualizing the assistance:

Concept was developed by IRM together with BAPPENAS.

9. Timetable for assistance design, processing, and implementation

a. Year included in CSP, CSP Update, RCSP, RCSP Update, or interregional work plan: 2006

b. Expected date of submission for approval
Nonlending (other than project preparatory): Q4, 2007

c. Period and duration of assistance
Nonlending: 24 months

10. Financing Plan

For nonlending

Grant TA funds

Source	Amount (\$)
ADB Financing	1,000,000
Government Financing	250,000
Other Financing 0	
Total Cost	1,250,000

Source: Asian Development Bank estimates.

¹ TA 3967-INO: Local Government Provision of Minimum Basic Services for the Poor in the amount of \$750,000.